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The Myth of Negotiability

James Steven Rogers

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THE MYTH OF NEGOTIABILITY†*

JAMES STEVEN ROGERS**

I. INTRODUCTION.....	266
II. TRADITIONAL ACCOUNT OF THE SIGNIFICANCE OF NEGOTIABILITY	268
III. BILLS AND NOTES TREATISES OF THE CLASSICAL ERA....	272
IV. ORGANIZATION OF COMMERCE IN THE PRE-MODERN ERA	284
V. WHY NEGOTIABILITY WASN'T IMPORTANT.....	291
VI. MAJOR LEGAL ISSUES OF THE LAW OF BILLS AND NOTES	294
A. <i>Acceptance</i>	295
1. Acceptance and the Commission Agent System	295
2. Acceptance Financing	298
B. <i>Dishonor</i>	301
1. Plight of Those Called Upon to Make Good Dishonored Bills.....	301
2. Disputes Between Judges and Juries	306
VII. SPECULATIONS ON THE ORIGINS OF THE MYTH.....	315
VIII. IMPLICATIONS FOR MODERN COMMERCIAL LAW	326
IX. IMPLICATIONS FOR LEGAL HISTORY	330

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The bibliographic information on treatises on the law of bills and notes used in this Article is derived, for the most part, from the collection and catalog of Harvard Law Library, whose staff have been most helpful and patient with my requests that they look for yet another edition of "Byles on Bills" or the like.

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I. INTRODUCTION

"Negotiable" is an ambiguous word. In common speech, "negotiable" is frequently used simply to mean transferable.¹ On the other hand, in the negative form it often carries the connotation that what appears to be a payment instrument is not intended to be genuine, as in the legend "non-negotiable" that one finds on play money, bogus checks used in advertising gimmicks, duplicate copies of money orders, and the like. As that usage indicates, the term has a great deal to do with the use of written instruments as payment devices.

Most twentieth century lawyers would probably assert that in legal usage the term has a specific technical meaning: to say that an instrument is negotiable means that it is of appropriate type and form to be governed by the holder in due course rules so that a bona fide purchaser for value takes the instrument free from all claims to it and free from most defenses of the parties obligated on it. Thus, unlike any other form of property, if a negotiable instrument is stolen and passed to a purchaser who qualifies as a holder in due course, the purchaser takes free of the claim of the true owner. Moreover, if a note or other negotiable instrument gets into the hands of one who qualifies as a holder in due course, it can be enforced against the maker despite most defenses that the maker would have had against the original payee.

There is, of course, a connection between the legal usage of negotiable as referring to a special set of rules about the rights of transferees, and the lay usage of negotiable as meaning something like "genuine money." The lawyers' usage reflects the basic assumption of the legal profession about the subject known variously as "Bills and Notes," "Negotiable Instruments Law," or "Commercial

¹ The definitions given in modern dictionaries range from those referring to simple transferability, *e.g.*, The Oxford English Dictionary (2d ed. 1989) ("Capable of being negotiated; transferable or assignable in the ordinary course of business from one person to another"); to those vaguely alluding to special legal rules, *e.g.*, The American Heritage Dictionary of the English Language (1978) ("Capable of being legally transferred from one person to another, either by delivery or by delivery and endorsement"); to those giving some version of the technical lawyer's sense of subject to the holder in due course rules, *e.g.*, Webster's Third New International Dictionary of the English Language Unabridged (1976) ("that can be transferred or assigned from one person to another in return for equivalent value by being delivered either with endorsement (as of an instrument payable to order) or without endorsement (as of an instrument payable to bearer) so that the title passes to the transferee who is not prejudiced in his rights by any defect or flaw in the title of prior parties nor by personal defenses available to prior parties among themselves provided in both cases that the transferee is a bona fide holder without notice").

Paper": that the holder in due course rules are the necessary legal attributes of the various instruments that have been used in payment transactions over the centuries, and therefore that the legal concept of negotiability has always been the keystone of the law governing these instruments. The thesis of this article is that these assumptions, taken as assertions about the history of the law of bills and notes, are false. I shall attempt to prove that thesis by examining practice and law concerning bills and notes in the period, extending from the early eighteenth century to the early nineteenth century, that I shall refer to as the "classical era" of the law of bills and notes. Inasmuch as this is the period when the use of bills and notes in payments was a regular part of commercial life, and when the law of bills and notes developed into a settled part of Anglo-American law, one would expect that the concept of negotiability would play a major role in the law of bills and notes of that era. Surprisingly, this is not the case. Rather, the evidence indicates that the concept of negotiability was at most a very minor aspect of the law of bills and notes in the classical era, and did not play a prominent role in the law of bills and notes until the late nineteenth century.²

Part II of this article reviews the traditional account of the significance of negotiability. Part III of the article examines the major treatises on the law of bills and notes in the classical era, showing that the concept of negotiability was all but unmentioned in them. The following three parts of the article attempt to explain this puzzling phenomenon. Part IV examines the organization of commerce in the classical era; Part V shows why the problems addressed by the holder in due course rules would not commonly have arisen in the characteristic commercial transactions of the classical era; and Part VI discusses the problems and disputes that really were of major concern in the law of bills and notes in the classical era. The final three parts offer some thoughts on the origins of the myth of negotiability in the late nineteenth century, and the implications of the findings presented in this article for modern commercial law and for legal history.

² This Article focuses on commercial practice and law in the period ending about the 1820s or 1830s. The traditional assumptions concerning negotiable instruments law and history may be somewhat more accurate as applied to the mid- to late-nineteenth century. Nonetheless the realization that the law of bills and notes in what I term the classical era was not centered on the holder in due course rules makes the nineteenth century story far more complex than is usually assumed. Part VII of the Article offers some tentative hypotheses about nineteenth century developments.

At the outset, it may be well to note that the ambiguity of the term negotiable poses serious difficulties in discussing these matters. Arguing that "negotiability" has not been an important part of "negotiable instruments law" sounds like disputing a definitional truism. As we shall see, however, legal usage of the term negotiable has not always been as settled as it seems to be today. Accordingly, it is dangerous to assume that any use of the word negotiable carries with it the modern legal meaning of "governed by the holder in due course rules." In the effort to minimize confusion, I shall generally refer to the body of law as "the law of bills and notes," or "the law of commercial paper," avoiding the phrase "negotiable instruments law" except where I specifically intend to call attention to the ambiguities wrapped up in that phrase. On the other hand, I shall endeavor to be uniform in usage of the noun form, "negotiability," as referring to the legal concept expressed in the rule that a holder in due course takes free from claims and defenses.

II. TRADITIONAL ACCOUNT OF THE SIGNIFICANCE OF NEGOTIABILITY

The dominant theme of the modern legal profession's sense of the law of commercial paper is that the concept of negotiability is and has always been the heart of this body of law. The preeminent place of the concept of negotiability is apparent from the typical pattern of organization of virtually any law text on the subject published from the late nineteenth century to the present. Almost invariably, books on the law of bills and notes or commercial paper begin with an introductory chapter or passage explaining the concept of negotiability. This passage will show how the concept of negotiability differs from the general rules of assignment applicable to other forms of property, and will explain why this special concept is essential to commercial transactions.³

³ The following passage from one of the first modern law students' hornbooks on the law of bills and notes is illustrative:

Negotiability is the property by which certain choses in action, that is, undertakings to pay, pass from hand to hand like money. The common law knew nothing of that; or rather the common law repudiated entirely the notion that a promise by A to B could be treated as a promise extending also to C. The utmost which the law allowed was assignment; and that only after long debate and serious misgiving. Assignment merely works the appointment of another as beneficiary of the assignor's rights; the assignee 'takes the shoes' of the assignor. That would never have served the purpose of circulating paper; that

The organization and focus of the balance of such books mirror the emphasis on the concept of negotiability that one finds in the introductory passages. The heart of the book will be the chapters dedicated to the holder in due course rules, specifying the requirements for qualification as a holder in due course and the rights that one acquires by so qualifying. Occasionally, the authors will explicitly state that the holder in due course concept is the heart of the subject, and the rest dross.⁴ Even if the book does not explicitly state that the holder in due course rules are the most important thing about this body of law, that message is clear from the book's organization. The chapter or chapters devoted to the holder in due course will be the major part of the book, and all other chapters will emphasize the relationship between the matters under discussion and the holder in due course doctrine. Thus, the chapter on the definition and formal requirements will explain that the point of the definitional rules is to specify the requirements that an instrument must meet if a purchaser is to qualify as a holder in due course. The chapter on transfer rules will explain that the key to the transfer rules is that unless the transfer takes the proper form, the transferee will not be a holder who can qualify as a holder in due course. The chapters on defenses to the liabilities of the parties will consist primarily of a differentiation of the "personal" defenses that cannot be asserted against a holder in due course from the "real" defenses that can.

In any event, if the law student has not caught the point by the end of her law school career, there is always that great separator of the wheat from the chaff, the bar review course. In the 1958 bar review course outline on the law of bills and notes, the summary of Section 52 of the Uniform Negotiable Instruments Law, defining the "holder in due course," includes the remark, printed in boldface type, all capitals, italics, and a larger font than any other text in the

purpose required a denial of the maxim *nemo dat quod non habet*. The new taker of a bill of exchange must have a perfect right, if his purchase was in due course, a right in no way to be affected by the rights of him from whom he bought it.

M.M. BIGELOW, ELEMENTS OF THE LAW OF BILLS, NOTES, AND CHEQUES 2-3 (1893). Bigelow was published by Little, Brown, and Company as part of its "Students' Series," described by the publisher as "carefully prepared treatises by competent writers on the elements of the law. Covering subjects taught in distinct courses in the leading law schools." Also published that year was Charles Norton's HAND-BOOK OF THE LAW OF BILLS AND NOTES, one of the earliest items in West Publishing Company's "Hornbook Series."

⁴ See, e.g., R. REDFIELD, THE LAW OF COMMERCIAL PAPER 263, 316 (1929).

book, that "THIS IS THE MOST IMPORTANT SINGLE SECTION IN THE NIL."⁵

By the early twentieth century, these assumptions about the function and importance of the concept of negotiability had become so deeply engrained in the professional culture that the authors of works on the law of bills and notes came to assume that the holder in due course rules have been the key elements of this body of law from its earliest stages. The introductory section of the modern books on the law of bills and notes or commercial paper frequently contain a passage on the development of the "law merchant" and the process of its incorporation into the common law in the era of Lord Mansfield. The usual story is that merchants had always recognized the desirability of transferring debt instruments as a form of currency and realized that this practice required a system of legal rules that provided the purchaser of an instrument with the protections of the holder in due course rules. On this assumption, the principal theme of the development of the law of bills and notes was the incorporation of the law merchant's concept of negotiability into the common law.⁶

⁵ SMITH'S REVIEW OF NEGOTIABLE INSTRUMENTS OR BILLS AND NOTES FOR LAW SCHOOL AND STATE BAR EXAMINATIONS 55 (1958). BRITTON'S HANDBOOK OF THE LAW OF BILLS AND NOTES (1943), perhaps the last major pre-U.C.C. work on the law of bills and notes, says essentially the same thing, though without the flashy typography: "this principle, with its ramifications, is, by far, the most important principle in the whole law of bills and notes."

⁶ The following passage from a 1900 work is typical of the story that has become familiar to several generations of twentieth century lawyers:

Originally all instruments, including bills of exchange, promissory notes and bank checks were non-negotiable—in the sense that the maker could, when asked for payment, deduct from the amount due on the instrument any just claim that he had against the original owner. Such a claim was termed a counter-claim, or set-off. In the revival of commerce in Italy, in the eleventh century, merchants and traders, feeling the need of a commercial instrument, similar to a bank bill that could be used in their barter and trade and commercial transactions, and realizing that no such instrument could be passed from hand to hand or sold readily, no matter how good the financial standing of the maker was, if he, the maker, could always insist on adjusting accounts with the original owner—adopted a custom later known as the law merchant, under which notes, checks, drafts, and bills of exchange, drawn in certain prescribed forms, and in the hands of a *bona fide* purchaser, could be enforced to their full extent against the maker, regardless of certain defenses or counter-claims that the maker might have against the original holder. Such instruments were negotiable and such was the origin of negotiability.

In England, embarrassments arose in the application of the common law to these forms of contract and it was only after a long struggle that the courts engrafted upon the common law the law merchant, by which the parties to bills

Thus, the traditional account of the significance of negotiability involves assertions about both substantive commercial law and legal history. The traditional account holds both that negotiability is an important and useful concept in modern law and that negotiability has been the keystone of the law of bills and notes from at least the eighteenth century, if not long before. In recent years, there has been some retreat from the view that negotiability is necessarily a beneficial doctrine in modern commercial transactions. For example, during the 1960s and 70s the application of the holder in due course rules to consumer transactions came under attack, culminating in 1975 with the promulgation of the Federal Trade Commission rule effectively annulling the doctrine in consumer transactions.⁷ For the most part, however, the central assumptions about the history of the law of bills and notes have gone unchallenged. Even Grant Gilmore, who in one of his last articles suggested that the twentieth century law of commercial paper was little more than a relic of a bygone era,⁸ did not question that negotiability was an essential doctrine in the commercial law and practice of the late eighteenth century. Rather, Gilmore only expressed, more forcefully than most, what many commercial law teachers and scholars have come to suspect, that modern commercial law may not sufficiently have adapted to the passing of the era in which private debt instruments circulated as a medium of exchange.

and notes were put upon a footing entirely different from that of parties to other contracts.

The customs and usages of merchants as to negotiability of bills of exchange finally came to be recognized and enforced but were not put on a firm basis until they received the sanction of parliament. Promissory notes were first recognized by the courts as negotiable and later were refused that recognition. Their negotiability was at last established in 1705 by a statute passed by parliament. The principles of this statute have been followed in a general way by the various states of this country and embodied in statutes.

J.M. OGDEN, *THE LAW OF NEGOTIABLE INSTRUMENTS* 9-10 (1909). Ogden's treatise was one of the major books on the law of bills and notes in the first half of the twentieth century. Five editions were published from 1909 through 1947.

The same assertion—that negotiability in its modern sense has been a preeminent concern of merchants and the law merchant from the late medieval period to the present—can be found in numerous other bills and notes treatises of the early twentieth century. *E.g.*, M.M. BIGELOW, *ELEMENTS OF THE LAW OF BILLS, NOTES, AND CHEQUES* 2-3 (1893); D.S. EDGAR & D.S. EDGAR, JR., *LAW OF BILLS AND NOTES* 32 (1935); R.A. REDFIELD, *THE LAW OF COMMERCIAL PAPER* 4-5 (1929); F.A. WHITNEY, *OUTLINE OF BILLS AND NOTES* 13-15 (1948).

⁷ C.F.R. § 433 (1975).

⁸ Gilmore, *Formalism and the Law of Negotiable Instruments*, 13 CREIGHTON L. REV. 441, 461 (1979) ("What Article 3 really is is a museum of antiquities—a treasure house crammed full of ancient artifacts whose use and function have long since been forgotten.").

Whatever one may think about the role of the holder in due course rules in modern commercial transactions, it seems nearly self-evident that negotiability must have been an essential attribute of commercial instruments in the era, predating modern banking and currency systems, when private mercantile instruments were the principal media of exchange. For example, in the United States, the issuance of legal tender paper money dates only from the time of the Civil War,⁹ and the establishment of anything like the modern managed national currency system in the United States can be dated only from the National Bank Act of 1864, or perhaps the Federal Reserve Act of 1913. Prior to the latter part of the nineteenth century, specie, that is, coined precious metals, was the only money, in the narrowest sense of legal tender. Commercial transactions were not, of course, settled by passing around bags of gold or silver. Rather, payments were commonly made by means of mercantile bills of exchange, circulating notes issued by individual banks, and other commercial instruments.

According to the traditional accounts of the history of the law of bills and notes, the concept of negotiability was absolutely essential to such payment systems because no one would be willing to accept a note or bill as a form of currency unless he took it free from defenses and claims arising out of the transactions in which it was issued or previously used. Thus, if we looked at sources on bills and notes law from the late eighteenth and early nineteenth centuries, we would expect to see extensive discussion of the defenses that could or could not be asserted against a bona fide purchaser of an instrument and of the rules for qualifying as such a purchaser. In fact, we find exactly the opposite. Odd as it may seem, an examination of the legal treatises published in the late eighteenth and early nineteenth centuries indicates that the concept of negotiability played a relatively minor role in the law of bills and notes in that era.

III. BILLS AND NOTES TREATISES OF THE CLASSICAL ERA

Four books stand out as the preeminent works on the law of bills and notes in the late eighteenth and early nineteenth centuries.

⁹ Moreover, these Civil War "greenbacks" were not regarded as a desirable element of a permanent monetary system but as at best a necessary evil to meet the extraordinary circumstances of the war and at worst a flagrant affront to the Constitution, sound public policy, and morality. See generally *Hepburn v. Griswold*, 75 U.S. (12 Wall.) 457 (1871); A.B. HEPBURN, *A HISTORY OF CURRENCY IN THE UNITED STATES* chs. XI-XIV (rev. ed. 1967); Dam, *The Legal Tender Cases*, 1981 Sup. Ct. Rev. 367.

In order of the appearance of the first editions, they are John Bayley, *A Short Treatise on the Law of Bills of Exchange, Cash Bills, and Promissory Notes* (1789);¹⁰ Stewart Kyd, *A Treatise on the Law of Bills of Exchange and Promissory Notes* (1790);¹¹ Joseph Chitty, *A Treatise on the Law of Bills of Exchange, Checks on Bankers, Promissory Notes, and Bank-Notes* (1799);¹² and John Byles, *A Practical Compendium of*

¹⁰ Six editions of *Bayley* were published in London from 1789 through 1849, as well as two American editions in 1826 and 1836, and the usual bootleg Dublin printings of some of the London editions. Bayley himself prepared the second edition, published in 1799, but after his appointment as a judge of King's Bench in 1808, the work was taken over by William Barnes, who put out a third edition in 1813. Barnes, however, died at a young age, and Bayley, while still on the bench, supervised the fourth and fifth editions in 1822 and 1830. The sixth, and last edition, edited by George Dowdeswell appeared in 1849, eight years after Bayley's death.

The first edition of *Bayley*, published in 1789 when Bayley was still a student at Grey's Inn, is a remarkable book. It runs only seventy pages, and consists of concise statements of black letter law, unencumbered by any explanation or description of the cases. It has very much the appearance of the "nutshells" and other such trots so beloved by students even today. Evidently, though, the market called for more exegesis, for the second and all later editions added extensive case summaries in the footnotes.

¹¹ The first edition of *Kyd* was published in London in 1790. There was a 1791 Dublin printing, but the next London edition I have seen was a 1795 edition entitled the third edition. American editions appeared in 1798 and 1800.

Kyd's treatise was quite different from, and in some ways superior to, Bayley's work. Where Bayley gave either bare black letter law, or black letter law with supporting case annotations, Kyd does a very good job of weaving together the statement of rules and principles with the rationales for the rules given in the decision. Stewart Kyd has the distinction of being the only author of a bills treatise ever to have been indicted for treason. In the 1790s he was a member of the Society for Constitutional Information and, along with Thomas Hardy, John Horne Tooke and ten others, was indicted for high treason in 1794. Hardy and Tooke were tried first and were acquitted, whereupon the charges against Kyd were dropped.

¹² At least eleven editions of *Chitty* were published in London from 1799 through 1878, and sixteen editions in the United States from 1803 through 1885. By the time of its later editions, it had become a massive tome; the 1885 American edition was a two volume work running over 1,000 pages.

Joseph Chitty, who lived from 1776 to 1841, might well lay claim to being the patron saint of legal writers, having been the first to make a good living publishing law books. He produced treatises on a myriad of subjects from apprentices to variances, as well as an edition of *Blackstone* and numerous collections of precedents and statutes. His four sons carried on the family tradition of law publishing. Joseph Chitty Jr. (c. 1800-1838), best known as the author of *CHITTY ON CONTRACTS*, also published in 1834 a book on the law of bills, which, confusingly, bears the same name as many of the editions of his father's work, *A PRACTICAL TREATISE ON BILLS OF EXCHANGE, PROMISSORY NOTES, AND BANKERS CHECKS*. The first hundred pages of this two volume work contain a brief and undistinguished outline of the law of bills. The value of the work is the following 1,600 pages, consisting of a verbatim reprinting of all of the statutes on bills and every reported decision of the English courts on bills and notes, arranged in chronological order, from *Martin v. Boure* in 1602 to *Easley v. Crockford* in 1833. The publication of such a work is compelling evidence of the extraordinary difficulty that nineteenth century lawyers faced in attempting to maintain a working library of the reporters. That task is not much easier today; were it not for my good fortune in

the Law of Bills of Exchange, Promissory Notes, Bankers' Cash-Notes, and Checks (1829).¹³ Each of these went through numerous editions. Together they dominated the field until at least the mid-nineteenth century. One can get a very clear picture of the profession's sense of this body of law by looking at the organization and emphasis of the topics in these four works.

The contrast between these late eighteenth and early nineteenth century works and a typical twentieth century book on negotiable instruments law could hardly be greater. The twentieth century works can aptly be described as books about the *concept of negotiability*. Uniformly they begin with a passage explaining the concept of negotiability and its significance. Uniformly they organize their treatment of the various issues covered around the special rights of holders in due course. In the late eighteenth and early nineteenth century books, on the other hand, one finds hardly a shred of mention of the concept of negotiability or the special rights of holders in due course or bona fide purchasers. Neither Bayley, nor Kyd, nor Chitty, nor Byles had an introductory passage or chapter explaining the concept of negotiability in the sense of freedom from claims and defenses. None of them had a passage contrasting negotiability from mere assignability. None of them had a separate chapter on holders in due course, or to use the earlier term, bona fide purchasers for value without notice. None of them organized the discussion of defenses to actions on negotiable instruments around the distinction between those defenses from which a bona fide purchaser takes free and those to which even a

obtaining a copy of *Chitty, Jr.*, I would probably still have several years to go in finishing this article, to say nothing of the larger project of which it is a part.

¹³ BYLES ON BILLS was the authority on the subject, both in England and the United States, through most of the nineteenth century. Indeed, it still is the standard work in England; the 26th edition was published in 1988, even outliving Chalmers' work on the Bills of Exchange Act he had written, which ceased publication in the 1970s.

John Barnard Byles, born in 1801, was a student of Chitty, and had a distinguished career in practice before being appointed a judge of Common Pleas in 1858. He authored and edited the bills treatise through the first nine editions, from 1829 to 1866. Thereafter, the work seems to have been handed down like the family jewels; M.B. Byles appears as editor in 1874, with W.J.B. Byles taking over in 1899.

In addition to his fame as an author and judge, Byles is also responsible for what, so far as I know, is the only Bills and Notes joke. The DICTIONARY OF NATIONAL BIOGRAPHY notes that from his retirement from the bench in 1873 until his death in 1884 he was "a well-known figure [in London] on his old white horse;" leaving one to wonder why the learned editors thought it necessary to describe the subject's horse, not standard information in a DNB entry. Another reference, which I have since misplaced, explains that the old judge named his horse "Bills" so that as he rode up people could say, "Here comes Byles on Bills."

bona fide purchaser takes subject. In short, none of the earlier works pays much attention to any of the issues or concepts that the latter works assume to have been the whole point of this body of law from the very outset.

The contrast between the early twentieth century books and the treatises of the classical era can readily be seen by examining the passages describing the distinguishing characteristics of negotiable instruments. The twentieth century books invariably state that the key definitional characteristic of negotiable instruments is negotiability, in the sense of freedom from claims and defenses, as contrasted with mere assignability. Sir William Holdsworth gives a typical modern definition in his classic work on the history of English law:

Before I begin to discuss the question of the origins of these instruments, it will perhaps be useful to concentrate attention upon the object of our search, by recalling the characteristic features of negotiability in our modern law. They are three in number: (i) Negotiable instruments are transferable by delivery if made payable to bearer, or by indorsement and delivery if made payable to order; and the transferee to whom they have been thus delivered can sue upon them in his own name. (ii) Consideration is presumed. (iii) A transferee, who takes one of these instruments in good faith and for value, acquires a good title, even though his transferor had a defective title, or no title at all.¹⁴

Thus, to the twentieth century writers, the defining characteristics are three: (1) transferability, (2) presumption of consideration, and (3) negotiability in the sense of freedom from claims and defenses. Moreover, as Holdsworth himself points out elsewhere,¹⁵ and as other writers emphasize,¹⁶ it is the third characteristic, negotiability, that is truly essential. By contrast, in Byles, we find the following passage:

By the common law of England no contract or debt is assignable, our ancestors appearing, in the times of

¹⁴ 8 W. HOLDSWORTH, *HISTORY OF ENGLISH LAW*, 113-14 (1926).

¹⁵ *Id.* at 165 (describing the holder in due course aspect of the negotiable instrument as "the most important and the most characteristic of all its features").

¹⁶ See, e.g., J.M. HOLDEN, *THE HISTORY OF NEGOTIABLE INSTRUMENTS IN ENGLISH LAW*, 25 & n.3 (1955).

simplicity, to have apprehended from such transfers much oppression and litigation. But mercantile experience has proved the assignment of debts to be indispensable, and bills of exchange to be the most convenient instruments for facilitating, securing, and authenticating the transfer. They have, therefore, come into universal use among all civilized nations, and the common law has recognized them as part of the *law merchant*.

The common law again distinguishes contracts into two kinds: contracts under seal or by deed; and contracts not under seal or simple contracts. Contracts under seal are valid without consideration; simple contracts are void unless consideration be averred in pleading and established in evidence.

All the contracts arising upon a bill of exchange are simple contracts, but they differ from other simple contracts in these two particulars; first, that the benefit of the contract is assignable at law; secondly, that consideration will be presumed 'till the contrary appear.'¹⁷

For Byles, then, there are *two*, not *three*, distinctive characteristics of negotiable instruments: (1) transferability and (2) presumption of consideration. The third characteristic found in the modern definitions—negotiability in the sense of freedom from claims and defenses—is conspicuously absent. This is not merely a matter of oversight or peculiarity in expression, for each of the other major early treatises, *Kyd*, *Bayley*, and *Chitty*, contains a similar passage specifying the *two* peculiar characteristics of bills of exchange as assignability and presumption of consideration,¹⁸ as do the numer-

¹⁷ J. BYLES, *THE LAW OF BILLS & EXCHANGE* 2 (8th ed.).

¹⁸ J. BAYLEY, *supra* note 10, at 1 ("A bill of Exchange is a written order or request, and a Promissory Note a written promise, for the payment of money; the peculiar privileges of which are, that they are always *prima facie* presumed to have been made upon a sufficient consideration, and may be negotiated."); S. KYD, *supra* note 11, at 30-32 ("But Bills of Exchange and Promissory Notes, though according to the general principles of law, they are to be considered only as evidences of a simple contract, are yet in this respect regarded as specialties . . . for unless the contrary be shewn by the defendant, they are always presumed to have been made on a good consideration But Bills of Exchange, though only securities, and consequently things in action, are so highly favored in the law, that not only are they assignable or negotiable without any fiction, but every person to whom they are transferred may maintain an action, in his own name, against any one who has before him, in the course of their negotiation, rendered himself responsible for their payment."); J. CHITTY, *ON BILLS* 1-2, 7-8 (1779) ("Bills of Exchange, whether foreign or inland, and Checks or Drafts on Bankers, are instruments by means of which a creditor may assign to a third person, not originally party to a contract, the *legal* as well as equitable interest in a debt raised by it, so as to vest in the assignee a right of action against the original debtor. Such

ous other works of the same era.¹⁹ Rather, the term "negotiable" meant quite a different thing to lawyers of the eighteenth and early nineteenth centuries than it did to lawyers of the late nineteenth and early twentieth centuries.

In the late nineteenth and early twentieth century works, negotiable instruments are distinguished from other forms of contract by distinguishing *negotiability* from mere assignability or transferability. In the eighteenth and early nineteenth century works, negotiable instruments are distinguished from other forms of contracts by distinguishing their *assignability* from the general common law rule proscribing the assignment of a chose in action and by distinguishing the characteristic of presumption of consideration, which negotiable instruments share with deeds and other specialties, from the requirement of proof of consideration for other simple contracts. In short, where modern lawyers regard the term "negotiable" as designating a particular species of transferability, and hence distinguish sharply between negotiability and assignability, the lawyers of the eighteenth and early nineteenth centuries used the term "negotiable" as essentially synonymous with "transferable."²⁰

In one sense, this difference in usage is not all that remarkable. It is hornbook law that the ancient common law hostility to the assignment of choses in action had all but died out by the latter part of the nineteenth century. It is not surprising, therefore, that at the time when the proscription against assignment retained vigor,

being the general description and nature of these instruments, the operation and effect which is given to them, is obviously directly opposed to an ancient rule of law, the founders of which refused to give any effect to the transfer of any possibility, right, title, or any other chose in action . . . Having thus endeavored to point out the peculiar property of bills of exchange, in respect of their being assignable, so as to give the assignee a right of action in his own name, a property which it has been already seen, few other choses in action possess, the author will proceed to state a further leading distinction between contracts evidenced by bills of exchange and other simple contracts, in respect of the former carrying with them the same internal evidence of consideration as contracts evidenced by bonds or other specialties.").

¹⁹ E.g., J.I. MAXWELL, A POCKET DICTIONARY OF THE LAW OF BILLS OF EXCHANGE, PROMISSORY NOTES, BANK NOTES, CHECKS 52 (1802); Z. SWIFT, A DIGEST OF THE LAW OF EVIDENCE . . . AND A TREATISE ON BILLS OF EXCHANGE AND PROMISSORY NOTES 247-48 (1810).

²⁰ See, e.g., Z. SWIFT, A DIGEST OF THE LAW OF EVIDENCE . . . AND A TREATISE ON BILLS OF EXCHANGE 298 (1810) ("All bills payable to a certain person, or order, or to the order of a certain person; or to a certain person, or bearer; or to the bearer generally; or where equivalent words are used: are transferable by indorsement, or delivering from hand to hand, *ad infinitum*: so as to vest the assignee with a right of action, on the instrument against the parties to it, in his own name. This is what constitutes the negotiable quality of the instrument . . .").

lawyers discussing negotiable instruments emphasized their transferable quality to distinguish them from other non-assignable choses in action. Once the proscription against assignment had withered, however, lawyers emphasized the distinctive transfer rules applied to negotiable instruments as contrasted with the generally applicable transfer rules. There is, though, a far more important implication. The traditional account of the history of the law of bills and notes largely collapses once we realize that when the lawyers of the eighteenth and early nineteenth centuries used the term "negotiable," they did not have in mind the holder in due course rules and doctrines.

The traditional story is that the whole point of the law of bills and notes is to facilitate the transfer of instruments in commerce by enabling them to circulate free from routine defenses arising out of the transaction in which they were issued.²¹ Freedom from routine defenses is taken to be the key to the use of negotiable instruments. Yet, if we look at the treatises of the eighteenth and early nineteenth centuries, we simply do not find any such emphasis on the problem of defenses. Although the twentieth century books always contain a lengthy section on defenses, organized in accordance with the holder in due course doctrine's distinction between real and personal defenses, the earlier books have no chapter on the holder in due course doctrine, and the coverage of defenses is not organized around that concept. Rather, the matters that would now be placed under the headings of real and personal defenses are treated in a variety of places in the books. For example, the defense that some party to the instrument lacked contractual capacity, on grounds of infancy, insanity, or the like, which would be treated in twentieth century books in the section on the real defenses, is often treated in the earlier books in a chapter or chapters entitled something like "Of the Parties to a Bill of Exchange" along with many other issues of capacity and agency. Similarly, the defenses that the twentieth century authors take to be the primary

²¹ See, e.g., Dolan, *Standby Letter of Credit and Fraud (Is the Standby Only Another Invention of the Goldsmiths in Lombard Street?)*, 7 CARDOZO L. REV. 1, 12 n.18 (1985) ("The value of the distinction in the law of negotiable instruments between defenses that are good against the holder in due course and those that are not lies in the fact that common, commercial defenses are eliminated and the unusual, egregious defenses are retained. In commercial sales the most common defenses are failure of consideration, i.e., breach of warranty, and fraud in the inducement (usually nothing more than a higher degree of warranty breach). Negotiable-instruments rules take those defenses away from the obligor because if he were to keep them, negotiable instruments would not work.").

concern of the law of bills and notes, such as breach of warranty, fraud, or other matters relating to the original payee's failure properly to render the performance for which the instrument was given, are treated in the earlier books in a variety of places, rarely with much prominence.

Thus, in both *Bayley* and *Kyd* the issues of the defenses of illegality, want, or failure of consideration are not covered in the principal chapters of the books on the use of bills and major legal issues concerning bills, but are tossed into a final chapter on procedure and evidence in actions on bills.²² In *Chitty*, the subject of consideration and the defenses of illegality, want, or failure of consideration are treated somewhat as an aside in a chapter on the form of bills of exchange in which Chitty gives the typical language of a bill of exchange, appending the discussion of consideration to his mention of the phrase "for value received" that customarily appeared in bills of exchange.²³

Even where these authors give defenses of failure of consideration and the like more prominence, the discussion is far from what one familiar with twentieth century works would expect. In the twentieth century books, the discussion of these defenses focuses on the original obligor's effort to raise defenses when sued by a transferee of the instrument. The matter of defenses between the original payee and the maker usually receives only brief treatment—at most the author will observe that if the original payee sues the maker, he can raise any defense that would be available to any other sort of contractual obligation. Having gotten that obvious point out of the way, the author will then turn to the important stuff—whether the maker can raise particular defenses against a holder in due course.

In the treatises of the classical era, the emphasis is just the reverse. *Byles on Bills*, for example, had, from its first edition in 1829, a separate chapter entitled "Of the Consideration" which covered, among other things, some of the defenses that twentieth

²² In the first edition of *Bayley*, this chapter is entitled "Of the Evidence necessary to intitle the Plaintiff to recover upon a Bill or Note, and the Defence which may be set up against him," and comprises eight pages of the total of seventy pages in the book. The consideration defenses get only four pages, most of that being on illegality of consideration. Similarly, the first edition of *Kyd* has a final chapter entitled "Of the Proof necessary at the Trial, and of the Defence that may be set up there," which accounts for twenty-nine pages of the total of 160 pages in the book. The consideration defenses are covered in the last five pages of this chapter.

²³ J. CHITTY, *supra* note 12, at 49-55.

century authors would discuss under the heading of real and personal defenses. Byles begins his chapter on consideration by explaining that although there is a presumption of consideration in actions on bills, that presumption may be rebutted in actions between immediate parties to a bill, so that it becomes necessary to consider how such defenses, if available, will be treated.²⁴ The chapter then proceeds to the heart of the discussion, a detailed examination of whether particular contentions do or do not give rise to good defenses of want, failure, or illegality of consideration. There is nothing of the sense, so prominent in the twentieth century books, that the problem is whether a bona fide purchaser takes subject to defenses available against the original holder, nor is there any mention of the argument that such special treatment for bona fide purchasers is necessary in order to promote the use of bills in commerce.²⁵ Indeed, the phrase "bona fide purchaser" does not even appear in the discussion.²⁶

The treatises of the late nineteenth century began to give the holder in due course rules somewhat greater prominence, but it

²⁴ J. BYLES, *supra* note 13, at 37-38.

²⁵ In Byles' discussion, the principle that a "holder in due course" is not subject to defenses is treated only as a consequence of the rules concerning proof of consideration:

The defendant is not in general permitted to put the plaintiff on proof of the consideration, without having given him notice before the trial that he will be called upon to go into such evidence, nor even then, unless the defendant can make out a *prima facie* case against him, by showing that the bill was obtained from the defendant by undue means, as by fraud, felony, or force; or that it was lost, or that he received no consideration. But he is at liberty to show positively by his own witness, absence or failure of consideration, without any notice; at least in an action between immediate parties.

Between immediate parties—that is, between the drawer and acceptor, between the payee and drawer, between the payee and maker of a note, between the indorsee and the indorser, the only consideration is that which moved from the plaintiff to the defendant, and the absence or failure of this consideration is a good defense to an action But, between remote parties—for example, between payee and acceptor, between indorsee and acceptor, between indorsee and remote indorser, two distinct considerations, at least, come in question: first, that which the defendant received for his liability; and secondly, that which the plaintiff gave for his title. If, in such a case, the defendant can show that he has an equity not to be charged, as if he can prove that he received no consideration for his liability, or that his signature to the bill was obtained by force or fraud, it is but reasonable that, after giving due notice to the plaintiff, he should require the plaintiff to show that he gave a valuable consideration for the bill, and that therefore the plaintiff has an equity to recover. Accordingly, an action between remote parties will not fail, unless in an absence or failure of both of these considerations.

Id.

²⁶ It was not until the eighth edition, published in 1862, that a passage expressly discussing the rights of a "bona fide holder," so denominated, was added to BYLES ON BILLS.

was not until the 1890s and early twentieth century that the concept of negotiability came to dominate the profession's sense of this body of law. Although later editions of some of the treatises of the classical era, particularly *Chitty* and *Byles*, continued in use until well into the late nineteenth and early twentieth centuries, several entirely new major treatises were published in the middle and late nineteenth century, particularly in America. Three authors' works seem to have been particularly successful: Joseph Story's *Commentaries on the Law of Bills of Exchange* (1843) and *Commentaries on the Law of Promissory Notes* (1845),²⁷ Theophilus Parsons's *Treatise on the Law of Promissory Notes and Bills of Exchange* (1863),²⁸ and John Daniel's *Treatise on the Law of Negotiable Instruments* (1876).²⁹

The pattern of organization in Story's treatises is essentially the same as in the late eighteenth and early nineteenth century works, with the concept of negotiability playing no major role in the organization of the work.³⁰ Parsons's 1863 treatise, however, begins to show the influence of the concept of negotiability. Parsons's treatise is, so far as I can tell, the first law book on bills and notes to include a chapter specifically devoted to the rights of bona fide holders of instruments.³¹ Moreover, Parsons seems to have been the first writer on bills and notes whose discussion of other doctrines of bills and notes is informed by consideration of the effect of the

²⁷ The first edition of Story's *COMMENTARIES ON THE LAW OF BILLS OF EXCHANGE* appeared in 1843, with subsequent editions in 1847, 1853, and 1860. Story published a separate work, entitled *COMMENTARIES ON THE LAW OF PROMISSORY NOTES, AND OF GUARANTIES OF NOTES, AND CHECKS ON BANKS AND BANKERS*, in 1845. The promissory notes work went through at least seven editions from 1845 through 1878.

²⁸ Theophilus Parsons (1797–1882) was a Professor of Law at the Harvard Law School from 1848 until 1869. His massive two volume *TREATISE ON NOTES AND BILLS* was published in 1863, with a second edition in 1876. Parsons was the son and namesake of the well-known jurist Theophilus Parsons (1750–1813) who sat as Chief Justice of the Massachusetts Supreme Judicial Court from 1806 until 1813.

²⁹ John Warwick Daniel (1842–1910) entered the practice of law in Lynchburg, Virginia in 1866 after service as an officer in the Confederate army. He was a prominent figure in Virginia politics in the late nineteenth century, serving in the state legislature in the 1870s and the United States Congress and Senate from 1884 until his death. The first edition of his *TREATISE ON THE LAW OF NEGOTIABLE INSTRUMENTS* was published in 1876. The work went through seven editions, the last appearing in 1933.

³⁰ As the passage quoted in note 37, *infra*, indicates, Story does give a far more explicit statement than the earlier works of the argument that the circulation of instruments would be impaired if a purchaser had to inquire into the circumstances of prior transactions.

³¹ The seventh chapter of the first volume is entitled "Of the Holder" and includes three sections, "Rights and Duties of the Holder," "Who is a *bona fide* Holder of Negotiable Paper," and "Against what Defenses a *bona fide* Holder is Protected." This is, however, a rather small part of the book, accounting for less than thirty pages in a work of nearly 1,500 pages.

rules on subsequent purchasers.³² By the time of Daniel's 1876 treatise, at least some aspects of the typical pattern of the early twentieth century books begins to appear. Daniel's statement of the definition of a negotiable instrument explicitly refers to the attribute of freedom from claims and defenses,³³ and he devotes several chapters to the rules governing bona fide holder status and rights.³⁴ In other respects, however, *Daniel* looks far more like a treatise of the classical era than a twentieth century work. The three chapters on bona fide purchasers are still a fairly small part of the book. By contrast, the discussion of presentment, protest, and notice of dishonor occupies a major part of the book.³⁵

Although the holder in due course rules are given more prominent treatment in these and other mid-nineteenth century treatises than in the works of the classical era, it was not until the very end of the nineteenth century that the concept of negotiability began to play the dominant role familiar to modern lawyers. Starting in the 1890s, there were countless one-volume treatises on the law of bills and notes, or negotiable instruments, organized, in the manner

³² For example, in his discussion of the formal definitional rules, Parsons notes that: To learn what qualities are essential to a negotiable promissory note, we must bear in mind the main purpose of the note, and of the law in relation to it. This is simply that the note may represent money, and do all the work of money in business transactions. For this purpose, the first requisite, that, indeed, which includes all the rest, is *certainty* There should be entire certainty and precision as to the amount to be paid. The reason of this is especially obvious; for if the note is to represent money effectually, there must be no chance of mistakes as to the amount of money of which it takes the place and performs the office.

PARSONS, *supra* note 28, at 30, 37.

³³ An instrument is called negotiable when the legal title to the instrument itself, and to the whole amount of the money expressed upon its face, may be transferred from one to another by indorsement and delivery by the holder, or by delivery only But while all choses in action are now transferable, the negotiable instrument is the only species which carries by transfer a clear title and a full measure; and like an instrument under seal imports a consideration.

³⁴ DANIEL, *supra* note 29, at 1, 2.

³⁵ Chapters twenty-four through twenty-six were entitled, respectively, "Nature and Rights of a *Bona Fide* Holder or Purchaser of Bills and Notes;" "Holder of Bills and Notes Transferred to him as Collateral Security; and Holder of Bills and Notes secured by Mortgage," and "Rights of a *Bona Fide* Holder or Purchaser of Negotiable Instruments originating in Fraud, Duress, or Violation of Authority."

³⁵ The first edition of *Daniel* was a two volume work of about 1,500 pages, divided into six "Books" and subdivided into fifty-six chapters. The three chapters on bona fide holders, totalling only eighty pages, were included as part of the rather heterogeneous third book, entitled THE NEGOTIATION OF THE INSTRUMENT which also covered acceptance, presentment, transfer, and choice of law. By comparison, the entire fourth book, of nearly two hundred pages, was devoted to protest and notice.

described at the beginning of this article, entirely around the concept of negotiability.³⁶

Lest I be misunderstood, I do not mean to say that the rules that twentieth century lawyers catalog under the heading of holder in due course were unknown in the classical era of the law of bills and notes. We do find statements in cases and treatises to the effect that circulation of bills is important, and that it would hinder circulation if those taking bills had to worry about the particular circumstances of prior transactions in which the bills had been used.³⁷ It is, however, quite a different matter to say that the holder in due course rules were the whole point of the law of bills and notes. Consider an analogy from the general law of contract. Any treatise or casebook on the law of contract will include a chapter dealing with the special problems posed by assignment of contractual rights. No one, though, would suggest that the rules on assignment are the single most important part of the law of contract; quite the contrary, that chapter is a prime candidate for omission as time runs short at the end of a semester. By contrast, in the law of commercial paper, the assumption has been that the rules on transfer are the very heart of the law. Thus, we have a major puzzlement. The twentieth century books all proceed on the assumption that the concept of negotiability and the rules permitting holders in due course to take free from defenses have always been the central, defining characteristics of the law of bills and notes, yet these topics are all but unmentioned in the major legal treatises of the classical era.

³⁶ E.g., A.W. BAYS, *THE LAW OF NEGOTIABLE PAPER* (1911); M.M. BIGELOW, *ELEMENTS OF THE LAW OF BILLS, NOTES, AND CHEQUES* (1893); C.P. NORTON, *HANDBOOK OF THE LAW OF BILLS AND NOTES* (1893); J.M. OGDEN, *THE LAW OF NEGOTIABLE INSTRUMENTS* (1909); L.J. TOMPKINS, *THE LAW OF PROMISSORY NOTES, DRAFTS, CHECKS, ETC.* (1901); W. WILLIS, *THE LAW OF NEGOTIABLE SECURITIES* (1896); S. WILLISTON, *NEGOTIABLE INSTRUMENTS* (1915).

³⁷ See, e.g., *Collins v. Martin*, 1 Bos. & Pul. 648, 126 Eng. Rep. 1113, 1115 (C.P. 1797) (Eyre, C.J.) ("For the purpose of rendering bills of exchange negotiable, the right of property in them passes with the bills. Every holder with the bills takes the property, and his title is stamped upon the bills themselves. The property and the possession are inseparable. This was necessary to make them negotiable, and in this respect they differ essentially from goods of which the property and possession may be in different persons."); J. STORY, *COMMENTARIES ON THE LAW OF BILLS OF EXCHANGE* 219-20 (2d ed. 1847) ("[T]he partial or even total failure of consideration, or fraud between the antecedent parties, will be no bar to the title of a *bonâ fide* Holder of the Bill, for a valuable consideration This doctrine . . . is indispensable to the security and circulation of negotiable instruments No third person could otherwise safely purchase any negotiable instrument, for his title might be completely overturned by some latent defect of this sort, of which he could not have any adequate means of knowledge, or institute any inquiries, which might not end in doubtful results, or embarrassing difficulties.")

IV. ORGANIZATION OF COMMERCE IN THE PRE-MODERN ERA

The first step in understanding the history of the law of bills and notes is to understand the organization of commerce in the era in which this law developed and flourished. The traditional view of the history of the law of bills and notes rests on the assumption that bills represented the payment obligation of buyers of goods in credit sales.³⁸ The problem, though, is that it is hard to see how such sales could have taken place in the era when bills developed. We know that bills developed in international trade, and were in common use, at least among sophisticated merchants, as early as the fourteenth century. Consider, then, a common form of trade in the late Middle Ages, such as the sale of spices or fine cloth from Italy to Bruges for redistribution through northern Europe. The traditional account of negotiable instruments history assumes that the merchant in Venice has sold the goods on credit to a merchant in Bruges, and that the Bruges merchant has given a bill or note representing his obligation to pay the purchase price. That assumes that the two merchants had somehow reached an agreement for the sale of a specific cargo of spices. How would that occur in a world without telegraphs, telephones, rapid mail service, or safe transportation facilities?

Possibly merchants could have reached agreement by mail, though the post between distant countries was hardly swift or sure. But why would a merchant in Bruges commit to a sale before the goods had been shipped? The hazards of transport were so great that he could not assure that a specific shipment would actually reach its destination. Moreover, if the risks of non-delivery, damage, or delay were not enough, there is the matter of price. Our hypothetical transaction assumes that the buyer in Bruges is willing to commit himself to a purchase at a specific price months in advance of the arrival of the goods, and, therefore, long before he has any way of knowing what the market price of such goods is likely to be at the time he receives them. The perils of the transport of the day not only endangered any specific shipment, but almost ensured that the supply of goods to a specific market would fluctuate wildly, and

³⁸ The hypothetical illustrations of bill transactions in the twentieth-century books almost invariably take this form. See, e.g., A.W. BAYS, *THE LAW OF NEGOTIABLE PAPER* 24-25 (1911); D.S. EDGAR & D.S. EDGAR, JR., *LAW OF BILLS AND NOTES* 13-14 (1935); H.H. HUMBLE, *THE LAW OF BILLS AND NOTES* 4-5 (1939); J.M. OGDEN, *THE LAW OF NEGOTIABLE INSTRUMENTS* 9-10 (1909); R.A. REDFIELD, *THE LAW OF COMMERCIAL PAPER* 12 (1929); F.A. WHITNEY, *OUTLINE OF BILLS AND NOTES* 13-15 (1948).

with it the price. Prediction of future prices, difficult even today in a world of instantaneous communication and rapid transport, was nearly impossible in the late middle ages—as is attested by the ready market that practitioners of the subtle art of price prediction through astrology found for their services even in the sophisticated commercial world of sixteenth century Antwerp.³⁹

The solution to this puzzlement is really quite simple. The Venetian spice merchant did not ship his cargo to a *buyer* in Bruges. He shipped to a merchant in Bruges who acted as a *commission agent*, selling the goods for the account of the Venetian merchant. The local sales by the commission agent might be for cash or on credit, but it was not those sales that gave rise to bills. Rather, bills arose out of the relationship between the commission agent and his principal. Once the commission agent in Bruges had sold the spices, he was holding funds for the account of his principal. Bills of exchange developed as a mechanism by which merchants could make use of the funds lying in the hands of their agents in distant locations.⁴⁰

³⁹ See R. EHRENBERG, *CAPITAL IN THE AGE OF THE RENAISSANCE* 240–42 (H.M. Lucas trans. 1928 & reprint 1963).

⁴⁰ In the simplest form of bill transaction, suppose that some other merchant in Bruges has shipped goods, such as English wool, to his representative in Venice who has sold them on commission. The Venetian agent of the Bruges wool merchant has funds due to the Bruges wool merchant, just as the Bruges agent of the Venetian spice merchant has funds in Bruges due to the Venetian merchant. If the amounts involved are equal, everyone's accounts could be squared by having the Bruges representative of the Venetian spice merchant pay money to the Bruges wool merchant, and the Venetian representative of the Bruges wool merchant pay money to the Venetian spice merchant. The mechanism might be as follows: in Bruges, the Bruges agent of the Venetian spice merchant would deliver the money to the Bruges wool merchant who would draw a bill of exchange on the Venetian agent of the Bruges wool merchant, payable to the Venetian spice merchant. The bill would be sent to the Venetian spice merchant, who would present it for payment to the Venetian agent of the Bruges wool merchant. In effect, the Venetian spice merchant's return cargo becomes the Bruges wool merchant's outward cargo, and vice versa. That, in short, is the simplest function of the bill of exchange—often referred to in the medieval and renaissance sources as merchants' exchange.

This account of the function of bills of exchange, though sufficiently accurate for present purposes, is considerably simplified. In particular, I have not here gone into the use of bills of exchange as a lending mechanism in the period in which the canonical proscription against usury had a major impact on the forms of business investment. Twentieth century research in business and economic history, particularly the work of Raymond de Roover, has made it clear that in the era up to perhaps the early seventeenth century, lending or investment was a principal function of exchange transactions. See, e.g., R. DE ROOVER, *MONEY BANKING AND CREDIT IN MEDIAEVAL BRUGES* (1948); GRESHAM ON FOREIGN EXCHANGE (1949); *THE MEDICI BANK* (1948); *L'EVOLUTION DE LA LETTRE DE CHANGE XIV–XVIII SIECLES* (1953). Accordingly all of the standard legal historians' accounts of the development of the law of bills and notes up to the age of Lords Holt and Mansfield are based on a misunderstanding of early exchange transactions. By the period that I refer to as the classical era, however, the usury and lending

This process of settling accounts between merchants and their foreign representatives was the essence of the development of bills of exchange. The writings of business and economic historians are filled with instances in which a merchant instructs his foreign commission agent to make return "in good bills." To take but one example, Power's research on a fifteenth century family of English Merchants of the Staple engaged in the export trade in English wool to Flanders, shows how the Staplers' foreign representatives transmitted back to England the proceeds of the sale of the wool via bills of exchange drawn in Flanders by merchants engaged in the import trade to England:

The third way by which the Staplers could transfer their money home [other than buying goods for import or sending coin] was by bills of exchange drawn upon the London offices of merchants who imported on a large scale, and this was the method they habitually employed; they "made it over," as the phrase went, usually by means of mercers, who were importers buying heavily at the Flemish marts. The Staplers had Flemish money in Calais, where they sold, and in the marts, where they collected their debts; they wanted English money in the Cotswolds and London, where they bought. The mercers had English money in London, where they sold, and needed Flemish money at the marts, where they bought. So the Stapler on the continent delivered his money to a mercer and received a bill of exchange payable at a future date in London in English money, the interest being expressed in the rate of exchange for different terms⁴¹

The development of the bill of exchange was an outgrowth of the development of a system of trade in which the characteristic form of business organization was the shipment of goods from one merchant to his representative in a distant location for sale by the foreign representative on commission for the account of the shipping merchant. This form of business organization was by no means confined to the Italian merchants who developed it. Rather, the system of trade through commission agent that evolved in Italy in the fourteenth century spread throughout Europe, and later other

aspects of exchange transactions were no longer of great significance. Thus, the picture of bill transactions as a means of making use of funds in the hands of one's commission agent suffices for purposes of this article.

⁴¹ Power, *The Wool Trade in the Fifteenth Century*, in *STUDIES IN ENGLISH TRADE IN THE FIFTEENTH CENTURY* 68 (E.E. Power & M.M. Postan ed. 1933).

parts of the world with which Europe traded. It remained the predominant form of business organization until developments in communications and transportation in the nineteenth century made possible other forms of business organization.⁴²

Thus, the commercial transactions that gave rise to bills were not necessarily credit sales of goods from seller to buyer.⁴³ Rather, a typical bill transaction was a merchant drawing on his factor for the proceeds of goods sold on commission.⁴⁴ The caselaw of the

⁴² See, e.g., N.S. BUCK, *THE DEVELOPMENT OF THE ORGANIZATION OF ANGLO-AMERICAN TRADE 1800-1850* (1925); V. HARRINGTON, *THE NEW YORK MERCHANT ON THE EVE OF THE REVOLUTION* 67-72 (1935); R.B. WESTERFIELD, *MIDDLEMEN IN ENGLISH BUSINESS* (1915); Willan, *The Factor or Agent in Foreign Trade*, in *STUDIES IN ELIZABETHAN FOREIGN TRADE* (1959). For an account of the causes of the decline of the commission merchant system in the late nineteenth century, see G. PORTER & H. LIVESAY, *MERCHANTS AND MANUFACTURERS* (1971).

⁴³ Indeed, there are various indications in the treatises of the classical era that transactions in which a seller draws on a buyer were regarded as exceptional, not ordinary. For example, Kyd's discussion of the phrase "value received" that was commonly included in bills notes that one occasionally encounters a different phrase, "value in himself," which variant form would be used where "a merchant draws a Bill of Exchange on one who owes him money, which he sends to his friend or factor, to procure acceptance and payment." KYD, *supra* note 11, at 40-41. Similarly, Glen, writing in 1807, discusses whether a drawee who had "effects" of the drawer is obligated to accept a bill drawn on him. He concludes that the answer should be no, because if that were the rule then a seller of goods could draw on the buyer without the specific consent of the buyer, which Glen thinks would be wholly unreasonable:

When I purchase a bale of broad cloth from a merchant of Leeds, or a box of muslins from a manufacturer of Manchester, I am liable for the price, after the expiry of the ordinary or stipulated period of credit; but I am not obligated to accept of bills drawn upon me for the price, without notice, and at random periods of payment.

GLEN, *A TREATISE ON THE LAW OF BILLS OF EXCHANGE, PROMISSORY NOTES, AND LETTERS OF CREDIT IN SCOTLAND* 125-26 (1807). If, as is usually assumed, the whole point of bills was that sellers regularly draw on their customers for each shipment, then there could hardly be any basis for suggestions of the sort we find here that there is something unusual about such transactions.

⁴⁴ Treatises of the classical era commonly provided sample forms of bills of exchange. The following is one of the examples given in Kyd's 1790 work:

London, January 18th, 1782

Exchange for £50 Sterl.

At sight . . . pay to Mr. John Rogers, or order, Fifty Pounds sterling, value received of him, and place the same to account, as per advice (or without further advice) from

SAMUEL SKINNER

To Mr. James Jenkins,

Merchant, in Bristol

If such a bill arose out of a merchant-factor transaction, then the parties would have had the following relations: Samuel Skinner, in London, having shipped goods on commission to his agent, James Jenkins, in Bristol, draws on the proceeds on the sale of the goods to make a payment to John Rogers, instructing Jenkins to debit the amount of the bill to Skinner's running account with Jenkins.

classical period confirms this picture of the paradigmatic bill of exchange transaction. In those cases in which the reports contain sufficient information to identify the nature of the underlying transactions among the parties, the pattern of merchant drawing on his factor frequently appears. For example, in *Foxcraft v. Devonshire*,⁴⁵ Satterthwaite shipped goods worth £ 5000 to his factor Devonshire who sold them for Foxcraft's account and sought to credit the proceeds against bills drawn by Satterthwaite on Devonshire and paid by Devonshire.⁴⁶ Similarly, *Maber v. Massias* was an action on a bill drawn by William Watts, an English merchant, on his factor in Gibraltar, Moses Massias, payable "out of the produce of goods you have of mine, now lying at Gibraltar, Barbary and Leghorn."⁴⁷ In *Mason v. Hunt*, Rowland Hunt, in Dominica, was said to have agreed with another firm of merchants in Dominica that if they shipped tobacco on consignment to Hunt's partner in London, the London partner would accept bills drawn in anticipation of the proceeds of the sale of the tobacco.⁴⁸

The relationship between drawer and drawee was not, though, confined to that of merchant drawing on his factor. Rather, any situation in which one person had or might have funds in his hands belonging to another might form the basis of a bill transaction. One commonly encounters cases in which an English importer's foreign factor buys goods for the merchant's account, paying or reimbursing himself by drawing a bill on his principal.⁴⁹ Thus, in *Francis v. Rucker*, an English firm instructed their correspondent in Philadelphia to buy corn for them and ship it to various Mediterranean ports.⁵⁰ The Philadelphia correspondent was authorized to draw on the English merchants for the cost of the corn purchased for their account.⁵¹ Many cases involved bills that arose out of other sorts of

⁴⁵ 1 Black W. 193, 96 Eng. Rep. 105 (K.B. 1759).

⁴⁶ Devonshire had paid the bills in question before he received and sold the goods for Satterthwaite's account. Satterthwaite's assignee in bankruptcy, Foxcraft, contended that Devonshire should be denied credit for the bills he paid because Devonshire knew at the time he paid the bills that Satterthwaite was in failing financial condition and paid the bills "to support a false credit in his principal." *Id.* at 105.

⁴⁷ 2 Black W. 1072, 96 Eng. Rep. 631, 631 (C.P. 1776).

⁴⁸ 1 Dougl. 297, 99 Eng. Rep. 192, 194 (K.B. 1780).

⁴⁹ *Barnaby v. Rigalt*, Cro. Car. 301, 79 Eng. Rep. 864 (C.P. 1633), one of the earliest reported decisions in the central courts on bills of exchange, is probably a case of this sort, though the report is too obscure to permit confident conclusion about the facts.

⁵⁰ Amb. 672, 27 Eng. Rep. 436 (Ch. 1768).

⁵¹ The English merchants failed, and their Philadelphia correspondent was required to pay the bills as drawer. The issue in the case was whether the Philadelphia merchant could

financial affairs, such as bills drawn on one's banker or other person who, as the contemporary phrase went, "kept one's cash."⁵² Indeed, one might have funds in another's hands in non-mercantile situations. For example, the case usually cited as the first reported decision on an inland bill, *Edgar v. Chut*,⁵³ was one in which a parson in Norfolk had funds in London and consented to draw a bill on his London friend and give it to a local butcher who needed London funds to pay for cattle.⁵⁴ There are also a fair number of cases of profligate sons surprised to find that dear old dad had finally had enough and dishonored the bills they had drawn on him.⁵⁵ Although the relationship between drawer and drawee in these cases may not have been merchant and factor, all involve essentially the same form of underlying transaction—the drawee has, or is hoped to act as if he had, funds of the drawer in his hands. Unlike the model of bill transactions assumed in the twentieth century treatises, these were not cases in which bills were given as embodiments of obligations to pay for goods sold on credit.

The realization that bills commonly arose out of the obligation of a commission merchant to return funds held for his principal sheds a great deal of light on the role of the transferability of bills. The picture one gets from most modern law books is that merchants have long wanted some form of transferable paper instrument and found that bills of exchange met the need. That is putting the cart before the horse. In the era in which the commission merchant system of distribution predominated, merchants would invariably find that they had balances due to them from their correspondents in various location around the country or the globe. Bills of exchange were the mechanism by which they could make use of these distant balances in the era before the development of a specialized financial system. That the bills were transferrable facilitated this system, but it was not the essential key to it. Indeed, one finds many cases in the classical era in which bills are used as a payment device without any transfer of the bill itself. For example, if a merchant

prove a claim in the English merchant's bankruptcy for the twenty percent damages that a holder of a protested bill could recover from the drawer under Pennsylvania law. *Id.*

⁵² See, e.g., *Grant v. Vaughan*, 3 Burr. 1516, 97 Eng. Rep. 957 (K.B. 1764) (instrument drawn by London merchant on his banker).

⁵³ 1 Keb. 592, 636, 83 Eng. Rep. 1130 (K.B. 1663).

⁵⁴ The parson quickly learned the wages of excessive trust. The butcher failed before reimbursing the parson, and though the parson had taken the precaution of instructing his London friend not to pay the bill until the parson got the money, the cattle seller succeeded in collecting from the parson as drawer of the bill. *Id.*

⁵⁵ See, e.g., *Witherly v. Sarsfield*, 1 Shower, K.B. 125, 89 Eng. Rep. 491 (Exch. Ch. 1686).

in Bristol had funds in the hands of his factor in London, and needed to make a payment to someone else in London, the Bristol merchant could do so by drawing a bill on his London factor, payable to his London creditor. The London creditor, as payee, could simply present the bill to the drawee and receive payment. No transfer or indorsement would be involved, but the bill would have served an essential role as a payment mechanism.⁵⁶

To be sure, bills were commonly transferred, but the characteristic of transferability is perhaps best understood not as an end in itself, but as a mechanism by which bills could be used to enable a merchant to make use of funds in the hands of correspondents in distant locations. For example, a Bristol merchant might be able to make a payment to his creditor in Bristol by giving him a bill drawn on his factor in London: the creditor would be willing to accept such a payment whether or not he had immediate need of funds in London, because he knew that many other people would have need of funds in London. The well-known case of *Peacock v. Rhodes*⁵⁷ is a perfect example. Rhodes, in Halifax in western Yorkshire, drew a bill on his London bankers payable to Ingham or order.⁵⁸ The bill passed through several hands before being stolen from Joseph Fisher at York, about forty miles northeast of Halifax. We next find the bill forty miles further to the northeast at the coastal port of Scarborough where a mercer took it in payment for cloth. From Scarborough the bill presumably was sent down to London by the regular coastal shipping routes, but was dishonored by the London bankers. Thus, from the bare facts of the report we can literally trace the physical path of the bill through a series of transfers closer and closer to the drawee.⁵⁹

⁵⁶ For example, in *Aymar v. Beers*, 7 Cow. 271 (N.Y. 1827) a Virginia farmer travelled to New York to sell his crop of wheat. The buyer paid by giving the farmer a bill drawn on their correspondent in Richmond, which the farmer took back with him when he returned home. The issue in the case was whether the drawer had been discharged by the payee's delay in presenting the bill for acceptance.

⁵⁷ 2 Dougl. 633, 99 Eng. Rep. 402 (K.B. 1781). *Peacock v. Rhodes* is well-known only because it, unlike most cases about bills in the classic era, did involve a question of the sort that modern lawyers have assumed to be the universal concern of that era. Lord Mansfield ruled in the case that once a bill payable to order had been indorsed in blank, a bona fide purchaser could get good title even though the bill had been stolen. *Id.* at 403.

⁵⁸ The report identifies the drawee only as "Smith, Payne, and Smith." *Id.* at 402. That firm was a well known London banking firm, established in 1758 to serve as the London correspondents of a Nottingham banking house. L.S. PRESSNELL, COUNTRY BANKING IN THE INDUSTRIAL REVOLUTION 105-09 (1956).

⁵⁹ In *Goupy v. Harden*, 7 Taunt. 159, 129 Eng. Rep. 64 (C.P. 1816), we can follow the

V. WHY NEGOTIABILITY WASN'T IMPORTANT

Once we understand the characteristic transactions of the classical era, it becomes easier to understand why the concept of negotiability, in the sense of freedom from claims and defenses, seems not to have played a particularly significant role in the law of bills and notes.

In the first place, the form of many bill transactions in the classical era was such that the defenses familiar to twentieth century lawyers would commonly not arise. Twentieth century lawyers have assumed that in the typical bill transaction, the person responsible for paying the bill (the drawee-acceptor) incurred his obligation on it for the purchase price of goods sold to him. Accordingly, it is possible that he will resist payment of the bill on the basis of defenses arising out of the sale. Undoubtedly transactions of that form occurred in the classical era, and they may have even become the rule by the middle of the nineteenth century.⁶⁰ Nonetheless, in the era in which the commission merchant system played a major role in the distribution of goods, many bills would arise out of a somewhat different form of transaction. A merchant might draw on his factor to make use of the funds in the factor's hands from the sale of the principal's goods, or on a banking house that had agreed to accept his bills as a form of finance. The obligation of the drawee-acceptor on the bill in such transactions was *not* an embodiment of a buyer's obligation to pay for goods purchased on credit. Rather, it was either a factor's obligation to remit collected funds to his principal, or a merchant banker's obligation to honor the commitment made when it accepted the bill. In such cases, it is hardly surprising that we do not see disputes about breach of warranty and other sales defenses that the traditional legal history leads us to expect.

To the extent that the treatises of the classical era do cover the question whether a holder is subject to consideration defenses, the focus is not the failure of consideration or breach of warranty defenses that figure so prominently in the twentieth century works. Rather the points discussed are usually *illegality* of consideration, mostly usury and gambling issues, and *want* of consideration.⁶¹ The

path of a bill in international commerce. The bill was drawn in London on a house in Lisbon. The payee indorsed it to a firm in Paris, who indorsed to a firm in Genoa, who had it presented to the drawee in Lisbon. *Id.*

⁶⁰ See, e.g., J.S. GIBBONS, *THE BANKS OF NEW YORK* 214-15 (1859).

⁶¹ See, e.g., S. KYD, *supra* note 11, at 276 (2d Amer. ed. 1800) ("Beside the different

want of consideration defense discussed in the treatises was quite different from anything we would put under that heading today. The example invariably given of want of consideration defense that would not be available against a remote party is that an acceptor who had received no value for his acceptance would still be liable to a holder for value, even if the holder knew that the acceptor had received no value.⁶² The situation contemplated by such discussions is that someone needing to raise money found that he could not do so on his own credit. Accordingly, the borrower found someone willing to act as his surety, implementing the arrangement by drawing a bill on the surety who accepted it even though he held no funds due to the drawer. The bill could then be discounted more readily. To say that the acceptor cannot defend in such cases on the basis of "want of consideration" means only that a person who has accepted a bill as an accommodation to the drawer is bound by that acceptance. Indeed, today that point would not even be described as a matter of want of consideration; rather, we would say that the consideration given to the borrower is sufficient consideration for the surety's promise as well. Thus, to the extent that the classical era treatises say anything about the point that the defense of want of consideration cannot be raised against bona fide purchasers, they are saying nothing more than that a surety's engagement is enforceable despite the fact that the surety himself did not receive anything from the creditor.

Although the circumstances of bill transactions in the classical era shed some light on the puzzling absence of discussion in the classical era of the sale of goods defenses that modern lawyers assume to be so significant, this cannot be a full explanation. Whether or not it was the archetypal bill transaction, it was certainly not unknown for a bill to be issued for a price of goods sold on credit.⁶³ Moreover, if a bill had been circulated as a medium of payment, an indorser might well incur his obligation on it in connection with the purchase of goods. Why then do we see no discus-

subjects of defense which may be collected from the general principles laid down in the preceding chapters, the most usual are those which arise either from the total want of consideration, or from the illegality of the consideration for which the bill or note was given.").

⁶² See, e.g., J. BYLES, *supra* note 13, at 38; J. CHITTY, *supra* note 12, at 51-52; S. KYD, *supra* note 11, at 276-77.

⁶³ See, e.g., *Tye v. Gwynne*, 2 Campb. 346, 170 Eng. Rep. 1179 (Lord Ellenborough at nisi prius 1809).

sion at all in the classical era of the point that modern lawyers have assumed to be central to the law of bills and notes?

The traditional legal history of the law of bills and notes assumes that in an action between the immediate parties to an instrument, one who had given the bill in exchange for goods sold to him, could resist payment of his obligation on the bill by raising problems with the goods. That assumption is an anachronism. Today it seems so obvious that a buyer sued for the price of goods can raise disputes about the quality of the goods as a defense that it is easy to forget that this is largely a product of procedural developments of the nineteenth century. Even as a matter of basic contract doctrine, the case traditionally cited as establishing the principle that one sued on a contract can defend on the grounds of the inadequacy of the other's performance is *Basten v. Butter*, decided in 1806.⁶⁴ At best, the doctrine dates back to Lord Mansfield's decision in *Boone v. Eyre*, in 1779.⁶⁵ Moreover, even after disputes about the quality of goods became available as defenses in general contract actions, the defense was not available when the buyer had given a bill or note for the price. As Chief Justice Tenterden put it in an 1830 decision,

the cases . . . have completely established the distinction between an action for the price of goods, and an action on the security given for them. In the former, the value only can be recovered; in the latter . . . the party holding bills given for the price of goods supplied can recover upon them, unless there has been a total failure of consideration. If the consideration fails partially, as by the inferiority of the article furnished to that ordered, the buyer must seek his remedy by a cross action.⁶⁶

It was not until the procedural developments of the late nineteenth century concerning set-off and counterclaim,⁶⁷ that one who had given a bill or note for goods was able to defend on grounds of breach of warranty or the like. Thus, the problem for which ne-

⁶⁴ 7 East 480, 103 Eng. Rep. 185 (K.B. 1806).

⁶⁵ 1 H. Bl. 273n, 126 Eng. Rep. 160 (K.B. 1779).

⁶⁶ *Obbard v. Betham, M. & M.* 483, 173 Eng. Rep. 1232, 1232, (Tenterden, C.J. at nisi prius 1830). *Accord*, *Tye v. Gwynne*, 2 Campb. 346, 170 Eng. Rep. 1179 (Lord Ellenborough at nisi prius 1809); *Morgan v. Richardson*, 1 Campb. 40n, (Lord Ellenborough at nisi prius).

⁶⁷ In English law, it was not until the Supreme Court of Judicature Act of 1873, 36 & 37 Vict. c. 66, that counterclaims became generally available in actions in the common law courts.

gotiability is assumed to be the solution did not develop until well after the period that the law of bills and notes became settled.

At the most fundamental level, however, the explanation of the unimportance of negotiability in the classical era lies in an anachronism of a different sort. The problems addressed by the concept of negotiability are questions about the rights of holders of instruments against persons who unquestionably are obligated on the instrument, and who are worth suing. The central problem is whether the solvent obligor can raise defenses. In the classical era, however, such problems were, as a practical matter, overshadowed by far more important questions; specifically, what happens when the person expected to pay becomes insolvent. The law of bills and notes in the classical era had to deal with a world in which payments were routinely made by transfer of instruments that might ultimately not be paid at all, due to the insolvency of the obligor. Faced with problems of that level of severity, the question whether some solvent obligor might have some sort of defense pales into insignificance.

VI. MAJOR LEGAL ISSUES OF THE LAW OF BILLS AND NOTES IN THE CLASSICAL ERA

The facts of a case such as *Peacock v. Rhodes* illustrate one of the central aspects of the payment system of the classical era: a bill might circulate for a considerable period of time before it was known whether the drawee would pay it. In such a case as *Peacock*, the bill might have circulated through many hands before it was even presented to the drawee for acceptance, so that the parties would not even have the benefit of the drawee's contractual obligation. Even after a bill was accepted, there remained the risk that the acceptor might become insolvent before the bill came due. The parties through whose hands the bill passed, however, were acting on the assumption that the drawee would ultimately pay the bill. They might, to be sure, have relied on the credit of prior parties to back up the bill, but the assumption governing the usual case would be that the drawee would pay the bill. If the drawee failed or for some other reason dishonored the bill, then all of the prior payment transactions effected by transfer of the bill might be unsettled as holders of the bill sought recourse against prior parties on their liability as indorsers or drawer. Many of the major legal issues presented by the payment system of the classical era arose out of this phenomenon.

A. Acceptance

The concept of acceptance plays very little role in present day commercial law.⁶⁸ In the classical era of bills and notes, however, acceptance was an everyday matter, and legal issues about acceptance were quite important. Because the whole point of bills was to make use of funds in another's hands as a medium of payment, the critical question for the holder of the bill was whether the drawee would agree to pay the bill, that is, accept. Thus, it is hardly surprising that issues about acceptance were matters of major concern.

Indeed, one of the striking points that emerges from a comparison of the legal treatises on bills and notes in the classical era and those of the twentieth century is the prominence given to acceptance issues. In a typical bills treatise of the late eighteenth or early nineteenth century, the chapter on acceptance is a major part of the book. In the first edition of *Bayley*, for example, the chapter on acceptance accounts for about one-fourth of the discussion of the substantive law of bills and notes.⁶⁹ By contrast, acceptance had become a minor issue in the books of the early twentieth century, and goes essentially unmentioned in most books of the late twentieth century.⁷⁰

1. Acceptance and the Commission Agent System

Many of the disputed issues about acceptance of bills grew out of the tension between the desirability of requiring a simple and swift answer to the question whether the drawee would pay and the

⁶⁸ One of the few remnants of acceptance in modern law is certification of checks. See U.C.C. § 3-411. Even that practice is becoming increasingly uncommon because certified checks are something of a nuisance in modern automated check processing.

⁶⁹ The first edition of *Bayley* was a small book, having only six chapters totalling seventy pages of principal text. Of this, the last two chapters, from pages forty-two to seventy dealt with procedure and evidence in actions on bills. Thus only the first four chapters, pages one to forty-one, dealt with substantive questions, of which one chapter of ten pages covered acceptance.

⁷⁰ The twentieth century hornbooks illustrate quite clearly the withering of acceptance issues. In the first edition of Bigelow's hornbook, M.M. BIGELOW, *ELEMENTS OF THE LAW OF BILLS, NOTES, AND CHEQUES* 2-3 (1893), acceptance accounts for only ten pages of a 255 page work, about four percent. In the last standard hornbook on bills and notes, W.E. BRITTON, *HANDBOOK OF THE LAW OF BILLS AND NOTES* (1943), acceptance is treated in only twenty-four pages of a 1,129 page book, about two percent. In the currently dominant hornbook on the U.C.C., J. WHITE AND R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* (2d ed. 1980) acceptance is treated in less than one page, and the passage consists entirely of paraphrase and quotation of the Code sections with no case citations or discussion at all.

need to take account of the practical realities of the merchant-factor relationship out of which bill transactions arose. Indeed, as is the case with many of the significant issues of the classical law of bills and notes, disputes about acceptance are nearly incomprehensible unless one realizes that the commission agent system of distribution was the characteristic commercial transaction of this era.

For example, it was well established that a drawee to whom a bill was presented should be given twenty-four hours to decide whether to accept, the rationale being that the drawee would need the "opportunity of examining into the accounts between himself and the drawer" in order to decide "whether he has effects of the drawer's in his hands."⁷¹ That explanation makes perfect sense if the transaction is one in which a merchant draws on his commission agent. On the other hand, if the characteristic transaction were as assumed by the twentieth century writers, then it should have been a far simpler matter for the drawee to decide whether to accept, for the bill would have been drawn for the purchase price of a specific shipment of goods to the drawee. Indeed, the language that is invariably used in describing the relationship between drawer and drawee—that the drawer had "effects in the hands of the drawee"—seems an extremely odd method of expression if what was being described was the drawee's obligation as buyer to pay the purchase price of goods bought from the drawer. On the other hand, it is an entirely natural means of expression if the classic transaction is that the drawer is drawing a bill on his factor for funds that the factor collected from the sale of goods on the drawer's account.⁷²

More telling still are the issues about qualified and partial acceptances. After some dispute, it was eventually settled that a drawee to whom a bill was presented might make his acceptance conditional on certain events, or might accept the bill only to a certain amount.⁷³ For example, in *Smith v. Abbott*, the drawee ac-

⁷¹ J. CHITTY, *supra* note 12, at 70, 72.

⁷² The tie between the law of bills and the merchant-factor relationship was even clearer in some other jurisdictions, as is illustrated by *Burrows v. Jemino*, 2 Str. 733, 93 Eng. Rep. 815 (Ch. 1727), in which a bill "was drawn upon the plaintiff at Leghorn, which he accepted: but by the law there, if a bill be accepted and the drawer fails, and the acceptor hath not sufficient effects of the drawer in his hands at the time of the acceptance, the acceptance becomes void." The acceptor obtained a judgment vacating his acceptance in an action in the Leghorn courts and, upon returning to England and being sued on his acceptance, obtained an injunction against the suit on the basis of the Leghorn decree. *Id.* at 815.

⁷³ J. BAYLEY, *supra* note 10, at 22-23; J. CHITTY, *supra* note 12, at 74-82; S. KYD, *supra* note 11, at 74-80. The holder presenting the bill would have the option of treating that as dishonor and protesting, but if the holder did go along with the qualified or partial accep-

cepted a bill "to pay it when the goods consigned to him, and for which the bill was drawn, were sold."⁷⁴ The goods were, in fact, sold, but the drawee refused to pay. In the action against the drawee on his acceptance, it was argued that the uncertainty of such a qualified acceptance should prevent it from having the usual effect of binding the acceptor to an action on the bill. The argument, though, was rejected, on the grounds that "it will affect trade, if factors are not allowed to use this caution, when bills are drawn before they have an opportunity to dispose of the goods."⁷⁵

The problem of partial acceptances was even more difficult. In *Wegersloff v. Keene*,⁷⁶ a merchant residing in Norway drew a bill for £ 127 on an English merchant. Upon presentment, the drawee checked his accounts, and finding that he had only £ 100 due to the drawer, wrote on the bill that he would accept it only for £ 100. Upon the drawee's failure to pay even the £ 100, the holder brought suit on the bill for the £ 100. The drawee was represented by John Strange, a young lawyer who was to have a distinguished career in the following decades.⁷⁷ Strange admitted that the undertaking might have the effect of a simple contract, but argued forcefully that it should not be regarded as giving rise to liability on the bill itself. The heart of Strange's argument was that tolerating partial acceptances would greatly confuse bill transactions and impair the circulation of bills, because it might result in a situation where the drawer or indorsers could face liability to several persons for different parts of the debt.⁷⁸

tance, it would bind the drawee if the condition did occur or to the extent of the partial acceptance. J. BYLES, *supra* note 13, at 71.

⁷⁴ 2 Str. 1152, 93 Eng. Rep. 1095, 1095, 7 Mod. 426, 87 Eng. Rep. 1334 (K.B. 1741). Similarly, in *Sproat v. Matthews*, 1 T.R. 182, 99 Eng. Rep. 1041 (K.B. 1786), a London merchant to whom a bill was presented for acceptance told the holder that the bill had been drawn against a cargo that the drawer had consigned to either him or another merchant in Bristol, so that he could accept only on the condition that the goods came to him.

⁷⁵ *Id.*

⁷⁶ 1 Str. 214, 93 Eng. Rep. 480 (K.B. 1719).

⁷⁷ *Id.* Strange had been called to the bar only a year before, in 1718. In later years he held office as king's counsel, solicitor general, recorder of London, and master of the rolls.

⁷⁸

The great benefit arising to the public[k] from these bills is, their being negotiable and passing about as well as money, for every body is sensible, that without the assistance of these bills our trade could never be carried on for want of sufficient specie; not to mention the trouble and danger in returning money, which is avoided by this expedient. It is this benefit which the public[k] receives from these bills, that has [i]ntituled them to all the favour they have received, of which innumerable instances might be given . . . Now if what is contended for on the other side should prevail, the public[k] will be deprived of this great

Thus, the court faced a dilemma. Merchants acting as commission agents might easily find themselves in the situation of the drawee in *Wegersloff*, and want to accept only to the extent of the funds they held for the drawer. Accommodating that need, however, would conflict with the objective of facilitating the system of bill circulation. Modern lawyers, familiar with the traditional accounts of the history and purposes of negotiable instruments, would have no difficulty guessing how that conflict would be resolved—Strange's argument should win hands down. The case, though, came out the other way. Evidently, eighteenth century judges did not see the choice between the needs of the actual transactions that gave rise to bills and the theoretical advantages of facilitating circulation in the way that later generations have assumed was central to the law of bills and notes.⁷⁹

2. Acceptance Financing

The acceptance of a bill of exchange is a form of credit transaction even in the simplest bill transaction where a merchant ships goods to his commission agent and draws a bill on the agent for the proceeds of the sale. To the extent that the drawer can obtain immediate value for the bill from someone before the drawee is called upon to pay it, the bill is being used as a credit device in addition to its role as a payment medium. The credit aspect of bills becomes even more prominent if the factor is willing to allow the merchant to draw a bill in advance of the factor's sale of the goods. If the factor's credit is good enough that the merchant will be able to sell that bill to someone else, then the factor, by lending his credit to the drawer, is effectively providing financing to the drawer for the sale of the goods.

This aspect of bill of exchange transactions became very significant in Dutch commercial practice in the eighteenth century.⁸⁰ The merchants of Amsterdam rose to dominance in European trade in the seventeenth century on the basis of their role as commission

benefit; for no man will take this bill as so much money in the way of trade, when he is to resort to one man for one part, and perhaps send out of the kingdom for the other, to a place where he has no correspondent.

Id. at 482-83.

⁷⁹ Although the report gives Strange's argument at length, there is relatively little account of the argument on the other side or reasons given by the judges—not surprising given that Strange was the reporter!

⁸⁰ See generally C. WILSON, *ANGLO-DUTCH COMMERCE AND FINANCE IN THE EIGHTEENTH CENTURY* (1941).

sales agents. Initially, the Amsterdam merchants actually did act as commission sales agents for the traffic in goods. Goods from all over Europe, and indeed, the world, were shipped to Amsterdam and resold there. Gradually, however, the role of the Amsterdam merchants shifted to pure finance.⁸¹ Although the legal description of principal and agent calls to mind a picture in which the principal is the major actor and the agent a mere instrumentality, the economic realities could be quite the opposite. The merchants of Amsterdam who acted as commission agents for other merchants throughout the world were often far wealthier, credit worthy, and powerful than their "principals." Accordingly, a merchant whose own credit would have counted for little might well find a ready market for his bills of exchange if he drew on an Amsterdam merchant who regularly accepted his bills. This form of finance growing out of the commission sales system spread throughout the world and remained the dominant method of finance until well into the nineteenth century. Such transactions were the bread and butter of the business of the great merchant banking houses of Amsterdam and London in the eighteenth and nineteenth centuries.⁸²

Many of the controversial issues of the law of bills of exchange in the classical era grew out of the circumstances of this pattern of bill finance. Perhaps the clearest example is the lengthy dispute over the issue of "virtual" and "extrinsic" acceptances.⁸³ In the bill finance transactions of the sort just described, the bill commonly played its principal credit role before it actually arrived at the drawee for acceptance. Thus, if an American cotton exporter was known to be a customer of a leading English merchant banking

⁸¹ Conservative merchants and public officials in Amsterdam generally frowned on the transformation of the Amsterdam merchants from goods merchants into pure finance houses, believing it important to the prosperity of Amsterdam that the goods actually pass through the Amsterdam warehouses. Even aside from such concerns of public economic policy, a merchant banking house might well want to insure that it received the commission sales business as well as the acceptance business, for the commission earned on the sale of the goods generally exceeded the commission earned for accepting bills. For example, the great nineteenth century merchant banking firm, the Barings, made it an important part of their policy to see to it that they got the commission on the sale of goods as well as the commission on the acceptance of bills arising out of the shipment of the goods. See R. Hidy, *THE HOUSE OF BARING IN AMERICAN TRADE AND FINANCE* (1949).

⁸² See N.S. BUCK, *THE DEVELOPMENT OF THE ORGANIZATION OF ANGLO-AMERICAN TRADE 1800-1850*, at 12-14 and *passim* (1925); R. Hidy, *supra* note 81, at 131-33.

⁸³ In the jargon of nineteenth century bills law, "extrinsic acceptance" referred to a collateral written undertaking to accept a bill already in existence, while "virtual acceptance" referred to the doctrine, adopted in America but not England, that a promise to accept bills to be drawn in the future could operate as an acceptance of those bills.

house, such as the Barings, and the Barings regularly accepted his bills, then he would be able to obtain financing in America by discounting the bills he drew on the Barings. The critical point, however, was that others in the local community knew that the American merchant was entitled to draw on the Barings. Thus, to facilitate the operations of the American merchant, the Barings might, in one form or another, have let it be known that he was entitled to draw on them, or, at the extreme, might have made a specific promise to accept specific bills that he drew.⁸⁴ Such undertakings seem to have been common in mercantile practice from an early date, for the seventeenth century works on mercantile affairs include discussions of such letters of credit.⁸⁵ In the late eighteenth and early nineteenth centuries, precise specification of the effect of such undertakings became a major issue of controversy in English and American law.

In 1765, King's Bench, under Lord Mansfield, held in the famous case of *Pillans v. Van Mierop*,⁸⁶ that an action would lie on a promise to accept a bill. The opinions do not clearly indicate whether the action was thought to be a contractual action for breach of the promise to accept, or whether the promise was treated as an acceptance itself, rendering the drawee liable on the bill. The distinction could be quite significant, aside from the differences in proof required, in that subsequent holders of the bill would have an action against the drawee if the promise amounted to an acceptance, but might have difficulty enforcing the undertaking if it operated only as a promise—running in favor of another—to accept the bill.⁸⁷ English decisions after *Pillans* established that a promise to accept bills to be drawn would not be treated as an acceptance itself,⁸⁸ although a promise to accept a bill that had already been drawn could operate as an acceptance.⁸⁹ American courts, however,

⁸⁴ R. Hidy, *supra* note 81, at 136-37.

⁸⁵ E.g., MALYNES, *LEX MERCATORIA* 76-77 (3d ed. 1685).

⁸⁶ 3 Burr. 1663, 97 Eng. Rep. 1035 (K.B. 1765).

⁸⁷ The problems posed by the English decisions for the letter of credit and similar devices were not overcome until a century after *Pillans*, when it was held that although nothing but a writing on the bill could count as an acceptance, a promise to accept bills was enforceable as a contractual undertaking even by later holders of the bills drawn under it. *In re Agra and Masterman's Bank*, 2 Ch. App. 391 (1867).

⁸⁸ *Bank of Ireland v. Archer & Daly*, 11 M. & W. 383, 152 Eng. Rep. 852 (K.B. 1843); *Johnson v. Collings*, 1 East 98, 102 Eng. Rep. 40 (1800).

⁸⁹ *Clarke v. Cock*, 4 East 57, 102 Eng. Rep. 751 (1803). Subsequent English legislation, however, required that acceptances be written on the bill itself. Regulation of Acceptance Act, 1821, 1 & 2 Geo. 4, ch. 78, § 2.

generally held that a promise to accept bills not yet drawn could render the drawee liable as acceptor of bills later drawn under the promise.⁹⁰

This now seemingly arcane dispute over "virtual acceptances," was, at the time, a matter of major commercial significance. For example, in 1837 the Bank of England decided to tighten up money and credit by, among other things, refusing financial accommodation to three major British merchant banking firms, T. Wiggin & Co., T. Wilson & Co. and George Wildes & Co., that had extensive dealings in the finance of American trade. The three firms promptly failed, with the result that some eight to ten million dollars worth of bills of exchange drawn by American merchants on the British houses were returned dishonored, setting off a chain of bankruptcies among American cotton exporters and other merchants.⁹¹ Many of the protested bills had been drawn under some form of letter of credit or other assurance of acceptance, giving rise to extensive litigation in the American courts about whether the British houses were bound either as acceptors or for breach of a promise to accept.⁹²

B. Dishonor

In late twentieth century payment system law, the basic assumption is that things usually do not go wrong. For example, because well over ninety-nine percent of all checks are paid, the check collection system works on the theory that we can assume that checks will be paid and establish special procedures for the exceptional cases.⁹³ By contrast, in the classical era of the law of bills and notes, instruments that had circulated as payment media frequently were dishonored, and the law of bills and notes was at every point designed with a careful eye toward the likelihood of dishonor.

1. Plight of Those Called Upon to Make Good Dishonored Bills

Any payment system based on the transfer of debts must deal with one fundamental question: If a debtor pays his creditor by

⁹⁰ *Coolidge v. Payson*, 15 U.S. (2 Wheat.) 66, 75 (1817).

⁹¹ The episode is briefly described in B. HAMMOND, *BANKS AND POLITICS IN AMERICA* 457-62 (1957) and W. B. SMITH, *ECONOMIC ASPECTS OF THE SECOND BANK OF THE UNITED STATES* 186-88 (1953).

⁹² See, e.g., *Russell v. Wiggin*, 21 F. Cas. 68 (C.C.D. Ma. 1842) (No. 12,165) (Story, J.); *Wildes v. Savage*, 29 F. Cas. 1226 (C.C.D. Ma. 1839) (No. 17,653) (Story, J.).

⁹³ See Rogers, *The Irrelevance of Negotiable Instruments Concepts in the Law of the Check-Based Payment System*, 65 TEX. L. REV. 929, 943-45 (1987).

transferring to him a debt due from a third party, is the debtor discharged or does he remain obligated in the event that the third party fails to pay the transferred debt? In the classical era of the law of bills and notes, this issue arose in two settings.

First, there were cases involving bank notes and checks, payable on demand. By the mid- to late- seventeenth century, it became common in London to make payment by directing one's banker, or, in the earlier stages, goldsmith, to transfer funds held on deposit to the creditor.⁹⁴ Various instruments were used, some in the form of notes issued by the banker payable to bearer and others in the form of drafts on the banker directing payment to the creditor.⁹⁵ By the beginning of the eighteenth century, the courts began to see many cases in which a debtor gave his creditor such an instrument, but the banker failed between the time the instrument was given and the time it was presented.⁹⁶ In *Ward v. Evans*,⁹⁷ Chief Justice Holt laid down the basic rule:

I am of the opinion, and always was (notwithstanding the noise and cry, that it is the use of Lombard-Street, as if the contrary opinion would blow up Lombard-Street) that the acceptance of such a note is not actual payment For when such a note is given in payment, it is always intended to be taken under this condition, to be payment if the money be paid thereon in convenient time. This note was demanded within convenient time, but if the party who takes the note, keep it by him for several days without demanding it, and the person who ought to pay it becomes insolvent, he that received it must bear the loss, because he prevented the other person from receiving the money by detaining the note in his custody.⁹⁸

As Holt's caustic remark about Lombard Street opinion suggests, this is an issue on which there might be considerable controversy.

⁹⁴ See R.D. RICHARDS, *THE EARLY HISTORY OF BANKING IN ENGLAND* 23-64 (1929).

⁹⁵ According to Chitty, in London the check form of instrument had largely displaced the note form by the time that he wrote, 1799, although notes were still commonly issued by country bankers. J. CHITTY, *supra* note 12, at 170-71.

⁹⁶ *Holme v. Barry*, 1 Str. 422, 93 Eng. Rep. 605 (K.B. 1720); *Mekkish v. Rawdon*, 2 Moore & Scott 570 (K.B. 1720); *Moore v. Warren*, 1 Str. 415, 93 Eng. Rep. 605 (K.B. 1720); *Turner v. Mead*, 1 Str. 416, 93 Eng. Rep. 606 (K.B. 1720); *Crawley v. Crowther*, Freem. Chy. 257, 22 Eng. Rep. 1194 (Ch. 1703); *Ward v. Evans*, 2 Ld. Raym 928, 92 Eng. Rep. 120 (K.B. 1702); *Phillips v. Phillips*, 2 Freem. Chy. 247, 22 Eng. Rep. 1188 (Ch. 1700); *Hill v. Lewis*, 1 Salk. 131, 91 Eng. Rep. 124 (K.B. 1693).

⁹⁷ 2 Ld. Raym 928, 92 Eng. Rep. 120 (K.B. 1702).

⁹⁸ *Id.* at 121.

On one side, treating such notes as only conditional payment may hinder their use, because the debtor could not be certain that the affair was closed. Yet, it is equally possible that the opposite rule may discourage use of bankers' notes, because creditors would be less willing to accept them if they lost all recourse against the debtor. In any event, history suggests that Holt's intuitions were right, for it remains the rule today that taking a check generally does not extinguish the underlying debt.⁹⁹

Second, there were cases involving ordinary bills of exchange or notes. Where a debtor gave such an instrument, he would almost always remain liable, for he would incur liability on the bill itself. Either the debtor would make payment by drawing a bill on someone who held his funds and give it to the creditor, in which case he was liable on the bill as drawer, or he would make payment by transferring a bill drawn by another, in which case he would ordinarily have to indorse the bill and so incur liability on it. In theory, one transferring such an instrument might have avoided liability on it, either by transferring it without indorsement if it had already been indorsed in blank, or by indorsing it without recourse. In practice, however, it was unlikely that a creditor would accept the bill that way, because a refusal to indorse would suggest that the debtor himself was suspicious about the soundness of the bill.¹⁰⁰ One of the main reasons that bills were an acceptable medium of exchange was that the accumulation of indorsements added security to the bill. As the saying went, the more indorsements, the better the bill.¹⁰¹

⁹⁹ If, however, a bearer instrument was given at the time of the original contract, rather than as payment of a pre-existing debt, Holt suggested that taking the note would discharge the debt. "I agree . . . that taking a note for goods sold is a payment, because it was part of the original contract; but paper is no payment where there is a precedent debt." *Id.* That distinction was followed in subsequent English cases. See, e.g., *Cambridge v. Allenby*, 6 Barn. & Cress. 373, 108 Eng. Rep. 489 (1827), and adopted in section 58 of the 1887 Bills of Exchange Act. The nineteenth century American decisions on the matter were in considerable disarray, see generally, 2 T. PARSONS, PROMISSORY NOTES AND BILLS OF EXCHANGE 150-207 (1863), and the Negotiable Instruments Law did not cover the issue, other than the provision in N.I.L. § 65(4) that one who negotiates an instrument by delivery warrants that he has no knowledge of any fact that would render it worthless. The U.C.C. draws no distinction between instruments given for pre-existing debts and those given at the time of the contract; rather, § 3-802 provides that taking an instrument does not amount to a discharge except where a bank is obligated on the instrument.

¹⁰⁰ According to Parsons, it became common in nineteenth century American cities for notes to be made payable to the maker himself and indorsed by him in blank, so that the notes could then be transferred by others without having either to indorse or indorse without recourse. 1 T. PARSONS, PROMISSORY NOTES AND BILLS OF EXCHANGE 17 (1863).

¹⁰¹ See *Heylyn v. Adamson*, 2 Burr. 669, 97 Eng. Rep. 503, 507 (K.B. 1759) (Mansfield,

Accustomed as we are today to modern payment systems, it is hard for us fully to appreciate the consequence of the principle that the drawer and indorsers of a bill are liable in the event of non-payment by the drawee. In the commercial world of the eighteenth century, any merchant would regularly have to take bills as a form of payment, because frequently no other payment medium was available. Then, in order to pass on the bills, the merchant would be called upon to indorse them. Though the merchant might well have considered any such specific transaction closed long ago, any indorser through whose hands the bill had passed might find himself called upon to pay it months later as a result of the failure of some other merchant, perhaps wholly unknown to him. For example, in 1795 an ambitious young Tennessee man travelled to Philadelphia where he sold some land to a Philadelphia merchant, taking the latter's note as payment. In turn, he bought goods, paying by indorsing over the note, and returned to Tennessee intending to set up business as a general merchant with the stock purchased in Philadelphia. Shortly after returning to Tennessee, however, the young man—one Andrew Jackson—learned that the Philadelphia merchant had failed, and Jackson was forced to pay the note, thereby losing the great bulk of his fortune.¹⁰²

The plight of indorsers called upon to honor bills that had passed through their hands explains a great deal of the law of bills and notes. Consider, for example, all of the rules about such matters as the precise time for payment that drearily occupy the first few chapters of most law books on the subject. If a bill is drawn payable six days after sight, does the day of sight count as one of the six?¹⁰³ Are "days of grace" allowed on promissory notes as well as bills of exchange?¹⁰⁴ If the date for payment is a Sunday or holiday, does the bill become due on the day before or the day after?¹⁰⁵ Does commencement day at Harvard College count as a holiday in Massachusetts?¹⁰⁶ Why would anyone spend money to have lawyers argue about such things if the dispute were with the principal obligor? Why not just wait until Tuesday to file suit rather than

C.J.) ("In common experience every body knows that the more indorsements a bill has, the greater credit it bears.")

¹⁰² J.S. BASSETT, *THE LIFE OF ANDREW JACKSON* 34 (1931); M. JAMES, *THE LIFE OF ANDREW JACKSON* 74-78 (1938); I J. PARTON, *LIFE OF ANDREW JACKSON* 242-44 (1860).

¹⁰³ *Coleman v. Sayer*, 1 Barn. 303, 94 Eng. Rep. 206 (K.B. 1728).

¹⁰⁴ *Brown v. Harraden*, 4 T.R. 148, 100 Eng. Rep. 943 (K.B. 1791).

¹⁰⁵ *Tassell v. Lewis*, 1 Ld. Raym 743, 91 Eng. Rep. 1397 (K.B. 1695).

¹⁰⁶ *City Bank v. Cutter*, 20 Mass. (3 Pick.) 414 (1826).

worrying about whether you could have sued on Monday? The answer, of course, is that the disputes that gave rise to so many of the picayune rules that fill the books on bills and notes were not suits against the principal obligor, but efforts by the holder of a dishonored bill to collect it from an indorser or drawer. Once the economic context is understood, it becomes obvious that the arcana of classical era bills and notes law were produced not by mindless pettifoggery but by the understandable desperation of people facing the prospect of financial ruin when called on to honor bills that may have passed through their hands months before in long-forgotten transactions.¹⁰⁷

There was, though, no satisfactory solution to the cases presenting wrenching stories of human distress that came before the courts when indorsers or drawers were called upon to make good dishonored bills. If sympathy for indorsers and drawers too greatly influenced the rules about procedure on dishonor, other problems would develop. Consider the situation of a holder of a bill when it appeared that the drawee might refuse to accept, or, having accepted, might be unable to pay. If it was completely clear that the drawee would not pay, the holder should certainly proceed promptly with the necessary steps to preserve rights against prior parties. The difficulty, though, came in cases where the drawee's failure to pay was less clearly anticipated. A holder who expected payment by the drawee might be lulled into a false sense of security and omit to take all the steps necessary to preserve his rights against prior parties. Even if the holder realized that there was some question about whether the drawee would pay, he faced a dilemma if the drawee equivocated. Should he immediately give notice of dishonor and proceed against prior parties, thereby incurring the inconvenience and expense of protest, notary fees, and lawsuits, or should he hold off for a short while in the hopes that the drawee would pay, thereby risking loss of his rights against prior parties on the grounds that by giving credit to the drawee he had discharged prior parties?¹⁰⁸ The more rigorous the rules about steps necessary to preserve rights against prior parties, the more difficult it would

¹⁰⁷ Indeed, an indorser who paid without quibbling might have been thought unusually honest. For example, Andrew Jackson did pay the notes of the failed Philadelphia merchant, which so impressed bankers of the era that in his later years it was said that Jackson's indorsement was better security than that of men ten times richer than he. See J. PARTON, *supra* note 102, at 249-50.

¹⁰⁸ *Tindal v. Brown*, 1 T.R. 167, 99 Eng. Rep. 1033 (K.B. 1786), discussed at text accompanying note 115, *infra*, is a perfect illustration of the problem.

become for holders to make sensible arrangements in trying to get the bills paid by the principal obligor.

2. Disputes Between Judges and Juries Over Rules on Dishonor

One manifestation of the intractable problems presented in actions against indorsers and drawers of dishonored bills was the controversy over the role of the jury in disputes about the time for presentment and notice of dishonor. As Lord Holt had observed in *Ward v. Evans*, one who had paid a debt with a note issued by a banker or goldsmith who subsequently failed might be able to escape liability to his creditor by arguing that the creditor had not acted diligently in presenting the note for payment. Similarly, in the case of ordinary bills, the holder was required to give notice of dishonor to prior parties, and would lose his rights of recourse by undue delay in giving notice. All of the conflict inherent in the plight of those who found themselves called on to make good another's failure were played out in the evolution of the rules on presentment and notice of dishonor.

In the first place, we see the tension manifested in the rationales given for the rule that a holder's failure to act diligently discharged prior parties. The earliest cases of discharge for want of timely notice of dishonor were generally actions against the drawers of ordinary bills, and the original rationale for the rule turned on the circumstances of the characteristic bill transaction in which a merchant drew on his factor for amounts due him for goods sold on commission. If the holder delayed for a long period in presenting the bill, or if the bill was dishonored but the drawer was not notified, then the drawer might in the meantime settle his accounts with his factor on the assumption that the bill had been paid, or continue to do business with the factor not realizing that he was defaulting on his obligations. As Chief Justice Treby of Common Pleas put it in a 1699 decision, "it may be prejudicial to commerce if a bill may rise up to charge the drawer at any distance of time, when, in the meantime, all reckonings are adjusted between the drawer and drawee."¹⁰⁹ On that rationale, one might think that the holder

¹⁰⁹ *Allen v. Dundas*, 1 Salk. 127, 100 Eng. Rep. 490 (C.P. 1789); *accord*, *Darrach v. Savage*, 1 Show. 155, 89 Eng. Rep. 509, Holt 113, 90 Eng. Rep. 961 (1691); *Mogadara v. Holt*, 12 Mod. 15, 88 Eng. Rep. 1134, Holt 113, 90 Eng. Rep. 961, 1 Show. 317, 89 Eng. Rep. 597 (K.B. 1691). By the end of the eighteenth century, the standard form of expression was that the drawer should be given notice so that he may withdraw his effects from the drawee. *See Bickerdike v. Bollman*, 1 T.R. 405, 410, 99 Eng. Rep. 1164, 1167 (K.B. 1786) (Buller, J.).

should be able to argue that in a particular case the drawer was not in fact prejudiced by the delay, or even that the drawer seeking discharge should have to prove that he was prejudiced. Indeed, in one of the earliest cases, Chief Justice Holt had said as much.¹¹⁰ During the course of the eighteenth century, however, the tie between rationale and rule became more attenuated, and the rule became fixed that delay in notice automatically discharged the drawer, regardless of actual prejudice.¹¹¹ In sum, what started as a response to a specific argument about why someone should not be called on to make good a dishonored bill evolved into a rigid rule that took no account of the specifics of the case. That, of course, is hardly a surprising development when there is not a satisfactory way of deciding what to do about the specific cases.

Although the rules on *whether* presentment and notice were required became quite rigid, some element of flexibility did remain in the specification of *when* such action was required. In the cases of bankers' notes and other demand paper, presentment was required within "a reasonable time." Similarly, upon dishonor of any bill, notice had to be given within "a reasonable time." Until the latter part of the eighteenth century, the question whether the holder had acted within a reasonable time was entirely left to the jury,¹¹² who, we may surmise, took account as best they could of the equities of the specific cases beyond the particular questions of timeliness of the holder's conduct.

In the 1780s, however, the judges of King's Bench became very dissatisfied with the unpredictable results of leaving the issue to juries and sought to take over the issue as a question of law. In *Medcalf v. Hall*,¹¹³ a debtor paid his creditor with a draft on his bankers. The draft was given at one o'clock in the afternoon, and the bankers failed at five. The debtor was sued on the original debt, and defended on the grounds that the creditor had delayed unduly by not presenting the draft within the remaining four hours during

¹¹⁰ *Mogadara*, 88 Eng. Rep. 1134. See also *Hart v. King*, 12 Mod. 310 (K.B. 1700).

¹¹¹ See J. CHITTY, JR., A PRACTICAL TREATISE ON BILLS OF EXCHANGE 57 (1834).

Moreover, although the original rationale of the discharge is rather difficult to apply to indorsers, who would generally have no dealings with the drawee, indorsers were given the benefit of the discharge as well as drawers. In *Heylyn v. Adamson*, 2 Burr. 669, 97 Eng. Rep. 503 (K.B. 1758), Lord Mansfield explained the indorsers' discharge on the basis of the purely formal theory that an indorsement is, in effect, the drawing of a new bill.

¹¹² *Hankey v. Trotman*, 1 Black. W. 1, 96 Eng. Rep. 1 (K.B. 1747); *Hoar v. Dacosta*, 2 Str. 910, 93 Eng. Rep. 935 (K.B. 1731); *Manwaring v. Harrison*, 1 Str. 508, 93 Eng. Rep. 666 (K.B. 1721); *Hill v. Lewis*, 1 Salk. 131, 91 Eng. Rep. 124 (K.B. 1693).

¹¹³ 3 Doug. 113, 99 Eng. Rep. 566 (K.B. 1782).

that day before the bankers failed. At the trial, Lord Mansfield left the issue to the jury, but his instructions and summary of the evidence left them in no doubt about how he thought it should be decided. He suggested that it would be very desirable to have "some certain rule to meet all cases of a like kind," and commented favorably on the rule among many London bankers and merchants that presentment within twenty-four hours sufficed. He also admonished the jury that if they "thought that a man taking a bill was to run to receive it, they must be aware of the inconvenience of taking drafts." The jury, though, in its inscrutable wisdom, did not take the hint and returned a verdict for the defendant. Mansfield directed a new trial, and the case came before the full bench on defendant's objection to the grant of a second trial. In his opinion Mansfield noted that, "[n]othing is more mischievous than uncertainty in commercial law. It would be terrible if every question were to make a cause, and to be decided according to the temper of a jury. If a rule is intended to apply to and govern a number of like cases, that rule is a rule of law." Justice Buller concurred and went further to suggest that it be established as a rule of law that presentment on the day after receipt sufficed. Mansfield and Ashurst were willing to adopt Buller's suggestion. Justice Willes agreed that there should be a new trial, but was reluctant to lay down a general rule. Thus, at the second trial, the matter was again left to the jury, and the jury stuck to their position returning a second verdict for the defendant, and "delivering their reason in writing, that, according to the usage of the city, there was sufficient time for the plaintiff either to have received it himself or to have sent it to his bankers." A rule for a new trial was again obtained, and brought up for consideration by the full bench, but before decision the plaintiff gave up and presented his claim in the bankruptcy proceedings against the bankers.¹¹⁴

¹¹⁴ There was another case, *Appleton v. Sweetapple*, 3 Dougl. 137, 99 Eng. Rep. 579 (K.B. 1782), involving a draft on the same bankers, Brown & Collinson, in which the creditor had received the draft at noon and deposited it for collection with his own bankers that afternoon. The collecting bank presented it to Brown & Collinson that evening, but following the practice among bankers it was not then paid, but was "marked," see *Robson v. Bennett*, 2 Taunt. 388, 127 Eng. Rep. 1128 (C.P. 1810), to be paid at the clearings the next day. The draft was not paid before Brown & Collinson failed, and the creditor sued on the original debt. As in *Medcalf*, the jury gave a verdict for the defendant, and the case came before King's Bench on a motion for new trial. Lord Mansfield backed off somewhat from the position taken in *Medcalf*, saying that although the general rule should be that presentment by the day after receipt sufficed, the time could be shortened by proof of a usage. He believed, however, that the usage had not been proved at trial. Judge Buller held to the

Four years later the question again came before King's Bench in *Tindal v. Brown*.¹¹⁵ Tindal was the holder of a note made by Donaldson and indorsed by Brown. On the day the note came due, Tindal sent his clerk to Donaldson to demand payment. Donaldson was not home, so the clerk left word, and returned the following morning. That day the clerk did find Donaldson home, and Donaldson said that he would pay the note when his bank was open. Donaldson, however, failed to do so, and when the clerk returned the following morning, Donaldson admitted that he could not pay it. The clerk then went to the indorser, Tindal, who refused to pay on the grounds that the holder's failure to notify him of dishonor on the first day that the note came due discharged him. The jury evidently believed that the holder had given notice within a reasonable time and gave a verdict against the indorser. On the motion for new trial, Mansfield stated that

What is reasonable notice is partly a question of fact, and partly a question of law. It may depend in some measure on facts; such as the distance at which the parties live from each other, the course of the post, &c. But wherever a rule can be laid down as to reasonableness, that should be decided by the Court, and adhered to by everyone for the sake of certainty.¹¹⁶

Judges Ashurst and Buller agreed that reasonableness of time should be regarded as a question of law. As Buller put it,

The numerous cases on this subject reflect great discredit on the Courts of Westminster. They do infinite mischief in the mercantile world; and this evil can only be remedied by doing what the Court wished to do in the case of *Medcalf* and *Hall*; by considering the reasonableness of time as a question of law and not of fact.¹¹⁷

Although the judges left little doubt about their frustration with the inconsistent results of juries in these matters,¹¹⁸ the case had

position that the question was purely one of law, and if any usage were alleged it should be for the court to judge whether the usage was reasonable. A new trial was granted, but, as in *Medcalf*, the jury returned another verdict for defendant at the second trial.

¹¹⁵ 1 T.R. 167, 99 Eng. Rep. 1033 (K.B. 1786).

¹¹⁶ *Id.* at 1034.

¹¹⁷ *Id.* at 1035.

¹¹⁸ As Mansfield said,

It was well observed by counsel that the juries were obstinate in the case of *Medcalf* and *Hall*, where they struggled so hard, in spite of the opinion of the Court, to narrow the rule, that they held you must in certain cases demand

come up on motion for new trial, so the Court's power was limited to granting a new trial. As in *Medcalf*, the jury stuck to its position and gave a second verdict for the holder. Counsel for the holder suggested that the judges should simply give up, rather than grant a third trial in a case involving only a small amount of money, but the judges held their ground and granted a third trial, at which the case was put to the jury only for a special verdict as to the facts and the court entered judgment for the indorser as a matter of law.¹¹⁹

Taking the issue from the jury was one thing; deciding what to do with it was another. Problems of specifying the precise obligations of a holder upon dishonor did not go away after *Tindal*; if anything, the problems came to occupy a larger and larger portion of the courts' time, for the judges had taken it upon themselves to resolve these matters by general rules rather than leaving them to the jury. From the end of the eighteenth century through the early nineteenth century, innumerable cases posed fine points about the diligence required of the holder of a dishonored bill.¹²⁰

The importance and difficulty of the task of specifying the rules on this subject is illustrated by the one instance in which the judges relented from their determination to establish fixed rules requiring timely notice of dishonor. In a 1786 decision, *Bickerdike v. Bollman*,¹²¹

payment on a banker's draft within an hour. Here the struggle is to give a greater latitude than is necessary.

Id. at 1034.

¹¹⁹ Although later decisions generally followed *Tindal*'s ruling that reasonableness of time was partly a question of law and partly of fact, the procedure employed in the last trial in *Tindal* of having the jury return a special verdict as to the facts with the judge ruling on the reasonableness of the time, seems not to have been generally adopted. Rather, we find later cases coming before the full bench on motions for new trial after the question had been left to the jury. *E.g.*, *Darbishire v. Barker*, 6 East 3, 102 Eng. Rep. 1184 (K.B. 1805). Moreover, in cases involving bills payable within a certain period after sight, there are decisions after *Tindal* explicitly holding that although the holder must either present the bill or put it into circulation within a reasonable time, the question of reasonableness must be left to the jury. *Fry v. Hill*, 7 Taunt. 397, 129 Eng. Rep. 158 (C.P. 1817); *Goupy v. Harden*, 7 Taunt. 159, 129 Eng. Rep. 64 (C.P. 1816). The treatise writers long after *Tindal* continued to note that it was unsettled whether the issue was for judge or jury. *See, e.g.*, J. BAYLEY, *BILLS OF EXCHANGE* ch. 7, § 1 (5th ed. 1830); J. CHITTY, *BILLS OF EXCHANGE* 237-38 (4th ed. 1811).

¹²⁰ *E.g.*, *Geill v. Jeremy*, 1 Moo. & M. 61, 173 Eng. Rep. 1081 (Tenterden at nisi prius 1827) (if no post goes out the next day, must holder give notice by the late post of day of receipt?); *Williams v. Smith*, 2 Barn. & Ald. 496, 106 Eng. Rep. 447 (K.B. 1819) (if party to be notified is in different city, must notice be sent by the next practical post, or is it sufficient to send by post the following day?); *Smith v. Mullett*, 2 Campb. 208, 170 Eng. Rep. 1131 (Ellenborough at nisi prius 1809) (is it sufficient if holder puts notice in post at end of day following receipt but too late for last post?); *Haynes v. Birks*, 3 Bos. & Pul. 599, 127 Eng. Rep. 323 (C.P. 1804) (if bill has been left with banker for collection, does this extend time for giving notice?).

¹²¹ 1 T.R. 405, 99 Eng. Rep. 1164 (K.B. 1786).

the judges of King's Bench showed that they too could be moved to bend the rules in light of the equities of particular cases. In that case, a hard pressed debtor tried to hold off one creditor by giving him a bill drawn on another firm. As it turned out, this was nothing but a crude stalling effort, for the firm on which the bill was drawn held no funds due to the drawer. Quite the contrary, the drawer actually owed a substantial sum to the drawee. The bill was, of course, dishonored, and the disgusted holder did not bother with the formalities usually required in ordinary bill dealings. When the creditor sued, however, the debtor brazenly put in the defense that the debt was discharged because the creditor had not given him notice of dishonor of the bogus bill. That was too much even for judges who had so strongly urged the adoption of clear, certain rules in bill dealings, and the court ruled that notice of dishonor was unnecessary in such a case.¹²²

It is unlikely that the judges who decided *Bickerdike* had any idea what a monster they had created. Parties fighting over liability on a dishonored bill now had a vehicle for arguing that the loss should fall on another, even though they may have slipped in the attempt to follow the rigid rules. There turned out to be many cases where bills were drawn on someone who held no effects of the drawer in perfectly legitimate circumstances where the drawer might well be prejudiced by lack of timely notice. For example, in the ordinary dealings between merchants, it commonly happened that a merchant shipped goods on commission to his agent and immediately drew a bill for the expected sales proceeds of the goods under an arrangement with the commission agent permitting him to draw in advance of the actual sale. In such cases, the drawer may have had no effects in the drawee's hands at the time the bill was drawn, for the goods might not even have arrived, yet the drawer had legitimate reason to assume that the drawee would honor the bill.¹²³ In other cases, the accounts between drawer and drawee fluctuated between the time the bill was drawn and the time it was

¹²² As Judge Buller explained,

The law requires notice to be given . . . because it is presumed that the bill is drawn on account of the drawee's having effects of the drawer in the hands; and if the latter has notice that the bill is not accepted, or not paid, he may withdraw them immediately. But if he has no effects in the other's hands, then he cannot be injured for want of notice.

Id. at 1167.

¹²³ See *Rucker v. Hiller*, 16 East 43, 104 Eng. Rep. 1005 (K.B. 1812); *Rogers v. Stephens*, 2 T.R. 713, 100 Eng. Rep. 384 (K.B. 1788).

presented and dishonored. Even though the drawer may, at some point, have had no effects in the drawee's hands, he could well be prejudiced by want of notice.¹²⁴ Moreover, if *Bickerdike* excused notice on the grounds that the drawer could not have been prejudiced where he had no effects in the drawee's hands, then should holders who failed to give notice in other circumstances be allowed to recover from prior parties by showing that they suffered no actual prejudice from the want of notice?¹²⁵

The judges struggled to confine the *Bickerdike* exception narrowly,¹²⁶ but the law on excuse of notice became exceedingly complex. As Theophilus Parsons put it in the introductory remarks to the chapter of his bills treatise dealing with the subject:

It may be doubted whether any branch of commercial law, somewhat narrow in itself, exhibits so large a number of cases, and so boundless a variety in their facts and the conclusions from them, as those which relate to the subject of this chapter. It is not easy to imagine any circumstance attending non-notice which in some form or other is not urged as an excuse for it. And the decisions of the courts permit authorities to be cited on both sides of almost any question.¹²⁷

Indeed, virtually every major judge of the English common law courts in the early nineteenth century expressed at some point great regret that the *Bickerdike* exception had ever been allowed.¹²⁸

Lawyers of the twentieth century have been so blinded by the conviction that negotiability has always been the heart and soul of

¹²⁴ See *Thackray v. Blackett*, 3 Campb. 164, 170 Eng. Rep. 1342 (Ellenborough at nisi prius 1812); *Blackhan v. Doren*, 2 Campb. 503, 170 Eng. Rep. 1232 (Ellenborough at nisi prius 1810); *Orr v. Maginnis*, 7 East 358, 103 Eng. Rep. 139 (K.B. 1806).

¹²⁵ See *Dennis v. Morrice*, 3 Esp. 158, 170 Eng. Rep. 572 (Kenyon at nisi prius 1800); *Staples v. Okines*, 1 Esp. 333, 170 Eng. Rep. 375 (Kenyon at nisi prius 1795).

¹²⁶ See *Blackhan v. Doren*, 2 Campb. 503, 170 Eng. Rep. 1232 (Ellenborough at nisi prius 1810); *Legge v. Thorpe*, 12 East 175, 104 Eng. Rep. 68 (K.B. 1810); *Orr v. Maginnis*, 7 East 358, 102 Eng. Rep. 139 (K.B. 1806); *Dennis v. Morrice*, 3 Esp. 158, 170 Eng. Rep. 572 (Kenyon at nisi prius 1800); *Staples v. Okines*, 1 Esp. 333, 170 Eng. Rep. 375 (Kenyon at nisi prius 1795).

¹²⁷ 1 T. PARSONS, *PROMISSORY NOTES AND BILLS OF EXCHANGE* at 521 (1863). The chapter on excuse of notice runs over 110 pages.

¹²⁸ See, e.g., *Cory v. Scott*, 3 B. & Ald. 619, 106 Eng. Rep. 787 (K.B. 1820) (Abbott, C.J.); *Ex parte Heath*, 2 Ves. & Bea. 240, 35 Eng. Rep. 310 (Ch. 1813) (Lord Eldon); *Orr v. Maginnis*, 7 East 359, 103 Eng. Rep. 139 (K.B. 1806) (Ellenborough, C.J.); *Clegg v. Cotton*, 3 Box. & Pul. 239, 127 Eng. Rep. 132 (C.P. 1802) (Alvanley, C.J.); *Dennis v. Morrice*, 3 Esp. 158, 170 Eng. Rep. 572 (Kenyon at nisi prius 1800); *Walwyn v. St. Quintin*, 1 Box. & Pul. 652, 126 Eng. Rep. 1115 (C.P. 1797) (Eyre, C.J.).

the law of bills and notes that they have difficulty understanding how anyone ever could have cared about what seem to be bizarrely picayune and inconsequential questions of presentment, notice of dishonor, excuse of notice, and the like. For example, in *White & Summers*—the dominant current treatise on the UCC—none of these topics even gets separate treatment in their own chapters or sections. Instead, there are only a few pages on these topics, introduced with the following remark:

Article Three, Part 5 defines "dishonor," "presentment," and related terms, specifies when presentment is necessary, and tells when one might give notice of dishonor—all in boring and incessant detail. At the risk of oversimplifying, but in the interest of lightening the reader's load, we will outline the pertinent provisions.¹²⁹

The author of a typical early twentieth century hornbook¹³⁰ is even more explicit about it. He dutifully devotes three chapters to presentment, notice, and protest, prefacing them with a suggestion that the reader need not bother reading them,¹³¹ and then breathes a great sigh of relief when he finally reaches the important material, the holder in due course rules:

The three chapters immediately preceding have dealt with matters of minute detail, these being the statutory regulations concerning the procedure at maturity. We have now emerged onto the high road again, which in this chapter [entitled "The Holder and His Rights"] traverses the very heart and center of our territory.¹³²

The twentieth century lawyers could not be more wrong. In the classical era of the law of bills and notes, the rules about holders in due course were a fairly minor point. The fine points of the rules concerning procedure on dishonor were the heart of the law of bills and notes in the classical era. The judges of the classical era frequently noted the importance of these matters. For example, in a case about the time for presentment of notes, Lord Kenyon re-

¹²⁹ WHITE & SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* § 13-10 at 506 (2d ed. 1980).

¹³⁰ R. REDFIELD, *THE LAW OF COMMERCIAL PAPER* (1929).

¹³¹ *Id.* at 263. ("Some readers may prefer to treat this chapter and the two immediately following as a reference matter. These chapters are occupied with consideration of detailed rules laid down by the Act for guidance through the formalities observable at maturity [T]he reader . . . may tread lightly over the ground in front of us.")

¹³² *Id.* at 316.

marked that "This question is of . . . infinite importance in every hour's transactions in the commercial world."¹³³ Similarly, Chief Justice Abbot noted that "It is of the greatest importance to commerce that some plain and precise rule should be laid down, to guide persons in all cases as to the time within which notices of the dishonour of bills must be given."¹³⁴ And in 1841, Lord Denham remarked that "Perhaps Lord Mansfield never conferred so great a benefit on the commercial world, as by his decision in *Tindal v. Brown*, where his perseverance compelled them, in spite of themselves, to submit to the doctrine of requiring immediate notice as a matter of law."¹³⁵

The treatises on bills and notes also evidence the preeminent importance of these issues. In a typical treatise of the late eighteenth or early nineteenth century, these issues make up the bulk of the book. For example, in the sixth edition of *Chitty*, published in 1822, the chapters dealing with the steps that the holder must follow in dealing with the drawee and preserving rights against prior parties account for a bit over one-third of the book. Moreover, in common with many of the treatises of that era, a great deal of the book (about one-third) was devoted to questions of procedure in litigation on bills and notes. Thus, of the part of the book dealing with the substance of the law of bills and notes, about one-half was devoted to these issues concerning unravelling the chains of payment transactions in the event of dishonor of the bill. Indeed, these questions about the procedures to be followed upon failure of the principal obligor to pay were matters of such concern in the everyday conduct of business that by the early nineteenth century, a ready market for vest pocket-sized guides to the law of bills and notes developed.¹³⁶ A late twentieth century law professor confronting a sea of yawning faces in a classroom discussion of the intricacies of Article 3 and 4 can only sigh wistfully upon reading in the preface to one such pocket book:

The following little Manual is designed for the use of
Traders and others having dealings in Bills of Exchange,

¹³³ *Brown v. Harraden*, 4 T.R. 148, 100 Eng. Rep. 943, 945 (K.B. 1791).

¹³⁴ *Williams v. Smith*, 2 Barn. & Ald. 496, 106 Eng. Rep. 447, 448 (K.B. 1819).

¹³⁵ *Furze v. Sharwood*, 2 Q.B. 388, 415, 114 Eng. Rep. 154, 164 (Q.B. 1841).

¹³⁶ J.I. MAXWELL, A POCKET DICTIONARY OF THE LAW OF BILLS OF EXCHANGE, PROMISSORY NOTES, CHECKS, &c. (1802); R. MUIR, A PRACTICAL SUMMARY OF THE LAW RELATING TO BILLS OF EXCHANGE AND PROMISSORY NOTES, INTENDED CHIEFLY FOR THE USE OF MERCHANTS (1836); J. ROLLE, THE POCKET COMPANION OF THE LAW OF BILLS OF EXCHANGE, PROMISSORY NOTES, DRAFTS, CHECKS, &c. (2d ed. 1815).

Promissory Notes, Checks, Drafts, &c. The extensive operation which these instruments have obtained in commercial transactions renders it unnecessary to expiate on the utility and importance of a publication like the present. In the whole of British law there is not perhaps, any branch (exempting those which regulate our civil rights and liberties) of more extensive import than that which regulates the effect and operation of Bills of Exchange and Promissory Notes. To be acquainted, therefore, with the nature and properties of these instruments; to know the laws and customs which regulate their presentment for acceptance, their presentment for payment, their payment, the notice of their dishonor, their protest, and the proceedings for the recovery of their value, is certainly not an useless or unprofitable acquisition; nor is the attempt to supply this necessary information at a trifling cost and in a portable form, a less useful or profitable undertaking.¹³⁷

Andrew Jackson would have understood.

VII. SPECULATIONS ON THE ORIGINS OF THE MYTH

The evidence is overwhelming that the law of bills and notes in the classical era was nothing like the body of law that is discussed in the late nineteenth and early twentieth century books. In particular, the common assumption of twentieth century lawyers and legal historians that the law of bills and notes developed in response to a universal mercantile need for debt instruments that could circulate as payment media free from defenses and claims is nothing but a myth. Although that assertion seems surprising at the outset, we have seen that once we delve into the specifics of actual mercantile practice in the eighteenth and early nineteenth centuries, it becomes easy to understand why issues about freedom from claims and defenses were not matters of major concern. We are, though, left with a different puzzle. What accounts for the transformation that brought the concept of negotiability to dominate the profession's sense of this body of law in the twentieth century?

Given the prominence of the concept of negotiability in the case law and treatises of the late nineteenth century, it would be foolish to deny that negotiability doctrines must have developed in response to some significant commercial need. It is, however, not

¹³⁷ J. ROLLE, *supra* note 136, at v-vi.

nearly as obvious what that commercial need was. If we surmise that the appearance of negotiability concepts in the treatises lagged a few decades behind the changes in litigation and commercial practice, then we may hypothesize that the mid-nineteenth century was the period of the development of the commercial practices that brought negotiability to the fore. One possibility is that with the development of modern rules of procedure concerning set-off and counterclaim, the defenses that previously could not have been asserted even in an action between the immediate parties now became available. Thus, the holder in due course rules might have become significant to protect remote parties against such set-offs or counterclaims. Indeed, a staunch supporter of the traditional account of the history of the law of bills and notes might contend that the evidence adduced in this article requires only a revision of the chronology—negotiability developed in response to the mercantile need for debt instruments that could circulate as payment media free from defenses and claims, although that need did not become critical until the mid- to late-nineteenth century.

That hypothesis, however, is difficult to square with the history of payment systems in the late nineteenth and early twentieth centuries. Ironically, the concept of negotiability came to dominate the law of bills and notes at about the same time that private mercantile instruments ceased to play an important role in the payment system. Scholars of economic and business history have noted that in both the United States and England, circulating private instruments largely passed from the scene by the latter part of the nineteenth century. The usual explanation for the American development is that around the time of the Civil War, the use of open book credit, with relatively short credit periods and a discount for cash payment, largely displaced the earlier practice of selling on long credit terms represented by notes or acceptances,¹³⁸ and that since that time American businessmen have not commonly used *any* written debt instruments in ordinary inter-business dealings.¹³⁹ In England, the usual explanation is that inland commercial bills largely ceased to perform any necessary function with the amalgamation of banking firms into a few large nationwide concerns.¹⁴⁰ These differing ex-

¹³⁸ See, e.g., B. KLEBANER, *COMMERCIAL BANKING IN THE UNITED STATES: A HISTORY* 80 (1974); G. PORTER & H. LIVESAY, *MERCHANTS AND MANUFACTURERS* 125-27 (1971).

¹³⁹ Credit sales among businesses are, of course, routine, but they are almost invariably conducted on an open account basis. See, e.g., R. SOLDOSKY & G. OLIVE, *FINANCIAL MANAGEMENT* 454 (1974).

¹⁴⁰ See A. FEAVEYER, *THE POUND STERLING* 318-21 (2d ed. 1963); S. NISHIMURA, *THE DECLINE OF INLAND BILLS OF EXCHANGE IN THE LONDON MONEY MARKET* (1971).

planations are probably flip sides of the same coin. In the classical era of bills and notes, the payment system was not separate from non-financial commercial dealings. Rather, every merchant was, in effect, one of the participants in the payment system. By the early twentieth century, however, the payment system had become a specialized function of financial institutions and governmental or quasi-governmental entities. Circulating paper currency was issued only by national banks of one sort or another, and the great bulk of payments were not made by circulating paper at all but by inter-bank transfers effected through the check system, clearing houses, and standard procedures for inter-regional check clearings.¹⁴¹

Thus, although liberalization of set-off and counterclaim rules in the late nineteenth century may have expanded the range of possible defenses to bills and notes, that should have been a matter of relatively minor concern to the payment system given that bills and notes were being replaced by other payment media. Accordingly, if the rise to prominence of the concept of negotiability is to be explained as a reflection of nineteenth century developments in commercial practice, we must look to transactions other than the circulation of mercantile instruments as a payment mechanism. One possibility, suggested by Gilmore, is that the holder in due course rules were important in the late nineteenth and early twentieth centuries because they happened to meet the desires of banks and other lenders in the emerging business of consumer lending.¹⁴²

¹⁴¹ One would expect that the law of bills and notes should have passed into oblivion with the passing of the subject matter. In a sense, that did happen. The real descendants of the topics about bills and notes that were matters of everyday concern to merchants of the eighteenth century are not found in Article 3 of the U.C.C., but in the rules about interbank procedures in check collections, bank credit card arrangements, and electronic funds transfers that are found, or buried, in various statutes, regulations and private agreements. Today, these are matters of concern only to the few bankers and bank lawyers who handle the occasional problems that arise. Merchants of the late eighteenth and early nineteenth century really did have good reason to carry around vest pocket guides to the law governing procedures on dishonored bills. By contrast, only the most peculiar of commercial law professors would today carry around a copy of the Federal Reserve System regulations on check collections.

¹⁴² Gilmore assumed that negotiability was an important aspect of the law of bills and notes in the eighteenth and early nineteenth century, so that his position was not that consumer lending gave rise to the concept of negotiability, but that these transactions were what kept it alive. As he put it:

My suggestion was that the whole thing was a sensitive and intuitive judicial response to the phenomenon of mercantile bills of exchange used as currency and circulating in a world-wide market. Now suppose that, after 1850, these bills were no longer used as currency, no longer circulated in a market and indeed disappeared. If nothing more was involved, we would expect the pre-1850 law of negotiable instruments to dry up and disappear—just as the no doubt beautifully organized law of sea-shells dried up and disappeared after

Although the advantage of the holder in due course doctrine to lenders in consumer finance might account for the survival of negotiability into the mid-twentieth century, it seems unlikely that the origins of the negotiability concept are to be found in consumer lending transactions. If we assume that the changes in commercial practice that gave rise to the prominence of the negotiability concept occurred sometime in the mid- to late-nineteenth century, then the phenomenon antedates significant consumer finance by decades.

A more plausible hypothesis is that the origins of the concept of negotiability are to be found in mid- to late-nineteenth century business practice; but that the relevant practice was not the circulation of instruments as a *payment* mechanism, but from the role of instruments in the *credit* system. Although exploration of this issue would take me well beyond the intended scope of this article, my preliminary research on nineteenth century practice suggests that the professionalization of the credit system lagged significantly behind the professionalization of the payment system. Even after checks had largely replaced circulating bills and notes as the ordinary means of payment in business transactions in major commercial centers, it appears that it was still quite common for businesses and others to raise money by issuing notes that might be sold to investors or banks through various sorts of brokers and other intermediaries. Indeed, the market for such notes seems to have served as a kind of auxiliary credit system for those who were unable to secure credit directly from banks.¹⁴³

One aspect of this credit system that might be particularly likely to have given rise to assertions of defenses was that many of the notes and bills were what eighteenth and nineteenth century writers described as mere accommodation bills—that is, they did not arise out of either an actual sale of goods or the shipment of goods to a commission agent, but were simply borrowings for miscellaneous purposes where the borrower's promise to repay the loan was

wampum ceased to be currency. Suppose further, however, that the pre-1850 negotiable instruments rules turned out to be exactly what a powerful group of entrepreneurs wanted in conjunction with novel types of transactions in which they were planning to engage . . .

. . . .
The banks . . . presently began to experiment with the novel idea of lending money to poor people. . . .

Gilmore, *Formalism and the Law of Negotiable Instruments*, 13 CREIGHTON L. REV. 441, 451-52 (1979).

¹⁴³ See Dailey, *The Early Development of the Note-Brokerage Business in Chicago*, 46 J. OF POLIT. ECON. 202 (1938).

backed up by the guaranty of various indorsers. Indorsers who were sued on instruments of that sort would be particularly likely to raise defenses, either their own suretyship defenses or defenses of the borrower asserted derivatively by the indorser. It is not difficult to see how the holder in due course rules on preclusion of defenses might come to play a far more significant role in credit transactions of that sort than in the eighteenth century payment system.

Another possibility is that the commercial practice that gave rise to the concept of negotiability was the expansion of the market for investment securities, particularly bonds. In support of the latter hypothesis, one might note that many of the late nineteenth century cases that are commonly cited as the clearest expressions of the meaning of negotiability involved not bills or notes as payment devices, but investment securities such as corporate debentures and government bonds,¹⁴⁴ and that many of the late nineteenth century treatises do devote a great deal of attention to investment securities.¹⁴⁵

Yet, even if we can identify some specific legal, commercial, or financial development in the late nineteenth century as the circumstance that prompted greater concern with the rules on claims and defenses, the explanation does not really seem adequate to explain why the concept of negotiability came to play such a dominant role. The changes in the law of bills and notes that might have been made necessary by liberalization of procedural rules or the development of new forms of instruments could easily have been accommodated within the same basic pattern of organization and emphasis that had characterized the books on bills and notes for over a century. Perhaps a new chapter or two on defenses or some new chapters on investment securities or consumer notes would be

¹⁴⁴ *E.g.*, *Goodwin v. Roberts*, 1 App. Cas. 476 (1876); *Crouch v. The Credit Foncier, Ltd.*, 8 L.R.-Q.B. 374 (1873).

¹⁴⁵ Daniel, for example, devotes several chapters of his treatise to corporate and municipal bonds, and in his preface remarks that one of the reasons he undertook work on the treatise was that the existing books predated the development of bonds.

[W]hen Chancellor Kent wrote his Commentaries, such a thing as a coupon bond was unknown in the United States. When Story sent forth his treatises on Bills and Notes from Cambridge, it was yet a feeble adventurer, timidly finding its way on the stock exchange. And although when Professor Parsons published his work in 1862, it had been recognized as a negotiable instrument, and was becoming familiar to the public eye, the law concerning it was yet in such an inchoate state that a few pages comprehended all that he saw fit to say about it. Now there is no more important figure in financial circles than a coupon bond.

J.W. DANIEL, 1 TREATISE OF THE LAW OF NEGOTIABLE INSTRUMENTS vi (1876).

needed, but the basic structure of the books could remain unchanged. That, however, is not what happened. Rather than openly discussing newly developing problems concerning new forms of instruments, the treatise authors of the late nineteenth and early twentieth centuries insisted that circulation of mercantile instruments as a payment mechanism was the practice that gave rise to the concept of negotiability. Similarly, rather than explaining that changes in commercial practice required changes in the law, the treatise authors emphatically asserted that the law of bills and notes had developed long ago and remained fundamentally unchanged through the centuries.

The late nineteenth century change in the law of bills and notes does not seem to have been merely an adaptation to changing commercial practice. Rather, there seems to have been a profound transformation in the profession's sense of this entire body of law. The nature of the transformation in this body of law may perhaps best be understood by considering how the subject is defined. There are, no doubt, many ways of describing and classifying the various ways that particular legal subjects are defined and delimited. For present purposes, I wish to note one such distinction. Consider the contrast between such subjects as the Law of Admiralty, Banking, or Sales, on the one hand, and the Law of Estoppel, Conversion, or Forfeiture, on the other. Legal subjects such as Admiralty or Banking Law represent classificatory approaches that start from non-legal categories. We regard it as sensible to talk about the Law of Banking, for example, because people do engage in banking and it is sometimes useful to consider together all of the various legal problems presented in the course of this distinct segment of human activity. Legal subjects such as Estoppel or Conversion, by contrast, represent classificatory approaches purely internal to the legal system. We regard it as sensible to talk about the Law of Estoppel, for example, not because we believe that people go around "estopping" or that that term describes a discrete body of human behavior, but because the concept of estoppel is used in the resolution of legal problems presented in a variety of settings, and it is sometimes useful to consider together all of the various ways in which that concept is used in the legal system. For want of better locutions, I shall use the term "exogenous" to refer to classifications of the sort that delimit the scope of a body of law by reference to a discrete body of non-legal behavior, and "endogenous" to refer to classifications of the sort that delimit the scope of a body of law by reference to purely legal concepts.

The essence of the transformation in the law of bills and notes that occurred sometime between the classical era and the twentieth century is that the defining principle of this body of law shifted from exogenous to endogenous. The shift is apparent even at the level of nomenclature. Consider the titles of the treatises. The full title of *Byles on Bills* was *A Practical Compendium of the Law of Bills of Exchange, Promissory Notes, Bank-Notes, Bankers' Cash-Notes and Checks*. The titles of all of the other treatises of that era take essentially the same form: "The Law of . . .," with the ellipsis filled in with a list of then current forms of instruments. By the end of the nineteenth century, however, the titles take quite a different form, the most common being *The Law of Negotiable Instruments*. The descriptive laundry list of forms of instruments used in mercantile practice has been replaced by a collective noun defined by the legal characteristic of negotiability. Indeed, the use of the noun form, "negotiability" seems to have become common only in the later part of the nineteenth century; earlier authors did use the phrase "negotiable instrument" as a shorthand for the laundry list, but seem to have felt no need for a noun to denote the special legal attribute of "negotiability."¹⁴⁶

The classical law of bills and notes was an exogenously defined body of law: it was the body of law that dealt with all of the various sorts of problems that arose from the actual transactions and practices of the seventeenth and eighteenth century merchants using bills and notes. Major portions of the treatises were devoted to such topics as the Stamp Act duties on bills and notes, extensive discussion of all of the agency law questions that might arise in connection with the use of bills and notes, lengthy discussions of pleading, evidence, and proof in actions on bills, discussions of proof and treatment of claims on bills in bankruptcy proceedings, criminal law issues concerning forgery of bills and notes, etc., etc.¹⁴⁷ This was an

¹⁴⁶ Although I did not keep notes on this specific point in examining the bills and notes treatises, the first use of the word "negotiability" that I recall was in Story's 1845 treatise on Promissory Notes, and the first use of the term in the modern sense was in Daniel's treatise in 1876. Even as late as 1898, use of the noun form seems to have been sufficiently unconventional that a casebook editor surrounded it with quotation marks. E. HUFFCUT, *THE LAW OF NEGOTIABLE INSTRUMENTS, STATUTES, CASES AND AUTHORITIES* 341 n.1 (1896) ("For a luminous discussion of 'negotiability' see Willis on Negotiable Securities (1896), Lectures I and II.")

¹⁴⁷ The title page of the eighth edition of *Chitty*, published in 1833, describes the work as:

A practical treatise on bills of exchange, checks on bankers, promissory notes, bankers cash notes, and bank notes. The 8th ed., newly modelled, and greatly

important body of law because the use of bills and notes was important to commerce as then conducted. The specific issues that were important were those that arose from the actual transactions, not from some jurisprudential theory.

By contrast, the negotiable instruments law of the late nineteenth and early twentieth century is an endogenously defined body of law: it is the law of negotiability, rather than the law of particular commercial instruments. The law turned inwards, so to speak, looking to its own legal concepts and categories as the points of major significance, rather than defining itself and concerning itself with problems and concerns drawn from an actual body of commercial practice. The treatises of the late nineteenth and early twentieth centuries invariably began with a lengthy, theoretical explanation and justification of the existence of a discrete body of negotiable instruments law—based entirely on the concept of negotiability. A major part of that discussion was frequently a discussion, at times surprisingly heated, of the exact correct meaning of the term “negotiable” that defined the subject matter.¹⁴⁸ Perhaps the most extreme instance of this phenomenon is found in the work of the English lawyer William Willis, who, in a series of lectures in 1896, insisted that an instrument could properly be described as negotiable only if it was in such form that a bona fide purchaser from a thief would take free of adverse claims, and thus instruments that required indorsement for transfer could not be negotiable because the title of subsequent purchasers depended on the validity of the indorsement.¹⁴⁹ Thus, for Willis the insistence on doctrinal purity would lead to exclusion from the subject of a great bulk of the instruments actually used in commerce. By contrast, the treatise writers of the classical era felt no particular need to explain or justify the existence of this body of law: the need for the law of bills and notes, and books discussing it, was self-evident. Bills were a regular part of everyday commercial life and this was the law resolving the problems that arose in everyday life.

enlarged and improved; with references to the law of Scotland, France, and America; and new chapters on agents, partners, consideration, stamps, requisites, loss, times of presentment, non-payment, protest and notice, evidence, bankruptcy, forgery, larceny, embezzlement, and false pretenses; and an appendix of precedents.

¹⁴⁸ See, e.g., Randall, Book Review, 29 LAW. Q. REV. 486 (1913) (reviewing B. JACOBS, A SHORT TREATISE ON THE LAW OF BILLS OF EXCHANGE, CHEQUES, PROMISSORY NOTES, AND NEGOTIABLE INSTRUMENTS generally (1913)).

¹⁴⁹ W. WILLIS, THE LAW OF NEGOTIABLE SECURITIES 6–8 (1896). Willis's lectures were evidently quite influential. At least five editions appeared in published form through 1930.

The topics covered in the treatises of the modern era also reflect this fundamental difference in approach. As I have already noted, the central organizing principle of the modern books is negotiability, in the sense of the holder in due course rules. Many of the topics that accounted for major parts of the treatises of the classical era, such as bankruptcy, procedure, evidence, and the like, are completely gone by the time of the treatises of the late nineteenth and early twentieth century, simply because they do not fit into the conception of this as a body of law centered around the concept of negotiability. Moreover, the material that still is included has been reorganized. Where a classical era treatise would have had separate lengthy chapters dealing with all questions of legal capacity and agency that might affect parties' obligations on bills, a twentieth century treatise will cover only parts of the topics in the course of discussion of the distinction between "real" and "personal" defenses. Perhaps the most striking change, though, is the treatment of the cases and rules about the rights of holders of lost or stolen instruments. In the classical era treatises, these topics were generally treated in a separate chapter, usually quite short and usually found in the back of the book with other miscellany of relatively little importance. By contrast, in the twentieth century books, *Miller v. Race*¹⁵⁰ is the case that defines the law of negotiable instruments, for it is the quintessential instance of the distinction between negotiability and mere assignability.

Changes in commercial practice in the late nineteenth century may well account for an increase in the number of cases posing problems about defenses and claims of the sort dealt with by the holder in due course rules. On the other hand, such changes in practice do not seem adequate to explain the radical transformation in the profession's sense of the body of law or the distorted portrayal of its history that is so prominent in the law books from the late nineteenth century. Thus, the problem of explaining the transformation of the classical era law of bills and notes into the twentieth century law of negotiable instruments may be more a matter of intellectual history than commercial history.

From the perspective of legal intellectual history, there is an intriguing coincidence between the transformation of the law of bills and notes and developments in the study of legal history. The concept of negotiability seems to have come to prominence in the

¹⁵⁰ 1 Burr. 452, 97 Eng. Rep. 398 (K.B. 1758) (bona fide purchaser of stolen bank note has good title).

legal literature at about the same time that lawyers began to be fascinated by the history of commercial law and the "law merchant." As has often been noted, it is very difficult to define specifically the concept of the "law merchant." For example, there is considerable dispute about whether references to the law merchant in early legal sources should be taken as referring to a body of substantive law separate and distinct from the common law, or only to more expeditious procedures than those of the common law courts. For present purposes, the interesting phenomenon is that the most influential works espousing the fully developed theory that the law merchant was a separate body of substantive law appeared in the late nineteenth century, at about the same time that the concept of negotiability was coming to dominate the law of bills and notes. The first work that I have found that sets out the now familiar story of a special mercantile law that was applied in the fair and staple courts and then eventually adopted by the common law in the eighteenth century was John MacDonnell's *Introduction* to the tenth edition of Smith's *Compendium of Mercantile Law*, published in 1890. That was followed within a year by Thomas Scrutton's enormously influential book, *Elements of Mercantile Law* (1893), and Edward Jenks's essay, *On The Early History of Negotiable Instruments*.¹⁵¹ Within a decade, virtually all of the treatises on the law of bills and notes incorporated the results of these works on legal history. As we have seen, a summary account of the evolution of the law merchant and its triumphant struggle with the common law is a standard accoutrement of the treatises on bills and notes from the turn of the century to the present.¹⁵²

¹⁵¹ 9 LAW. Q. REV. 70 (1893).

¹⁵² Although the bills and notes treatises of the classical era did commonly include a brief discussion of the history of bills and notes, these passages were quite different from those that we find in the twentieth century works. The twentieth century books tell a jurisprudential story: the focus is the incorporation of the law merchant into the common law. By contrast, the classical era treatises offer a simple account of commercial history: they give brief anecdotal or apocryphal accounts of early uses of bills of exchange and promissory notes, and of the seventeenth century cases in the common law courts involving bills and notes. There is generally no mention of mercantile courts at fairs and markets, nor any suggestion that the law of bills and notes was a part of an alien body of substantive law that was not applied in the regular English courts until the "incorporation" in the eighteenth century. Rather, the development of the law of bills and notes was described as an adaptation of English law to developing commercial practice. Byles, for example, describes the development of English law on bills as follows:

At the first introduction of bills of exchange, however, the English Courts of Law regarded them with a jealous and evil eye, allowing them only between merchants; but their obvious advantages soon compelled the Judges to sanction

The view that negotiability has always been the keystone of the law of bills and notes may, then, come not from commercial law, but from legal history. It is quite clear that the concept of negotiability has played a central role in the theory of commercial legal history developed in the late nineteenth century. In discussions of the battle of the law merchant with the common law, negotiability is invariably cited as the key example of an issue on which the two bodies of law differed. Accordingly, legal historians have tended to assume that determining the extent to which the common law at a particular period recognized the principle of negotiability provides the "acid test" of the progress of incorporation.¹⁵³ The late nineteenth century transformation of the law of bills and notes may be an instance of mutually reinforcing, if not circular, influences between legal history and substantive commercial law. The prominence of the concept of negotiability in modern substantive commercial law may be a reflection of the key role that negotiability has played in the incorporation theory of commercial legal history. Conversely, the incorporation theory may have developed in large measure out of the effort to explain how the legal system accommodated the assumed universal mercantile need for rules permitting debt instruments to circulate free from claims and defenses.

These thoughts and surmises certainly do not provide any definitive account of the development in the late nineteenth century of the myth that negotiability has always been the keystone of the law of bills and notes. A satisfactory explanation of the late nineteenth century transformation of the law of bills and notes would require a far more detailed examination of commercial practice and

their use by all persons; and of late years the policy of the Bench has been industriously to remove every impediment, and add all possible facilities to these wheels of the vast commercial system.

J. BYLES, *supra* note 13, at x. Even Chitty, who emphasizes the contrast between the law of bills and the basic English rule of the inalienability of choses in action more than any other author of the classical era, speaks of the law of bills as a native development of English law:

In short, it may be observed, that *our courts*, subservient, as it were, to the necessity and circumstances of the times, have, in favour of commerce, adopted a less technical mode of considering personalty than realty; and, in support of commercial transactions, have *established* the law merchant, which is a system of equity founded on the rules of equity, and governed in all its parts by plain justice and good faith.

J. CHITTY, *supra* note 12, at 7 (emphasis added).

¹⁵³ General treatment of the law merchant will, of course, include insurance, admiralty, and other topics, but the law of bills and notes is always cited as the pre-eminent example. The more enthusiastic proponents of the story have even asserted that the principle of negotiability was the law merchant. See, e.g., J.M. OGDEN, *supra* note 6, at 9-10.

law from the classical era to the present, and of general trends in late nineteenth century legal thought, than I have provided in this article. Leaving that problem unresolved, I shall turn to some thoughts on other unanswered questions; for whether or not we can find a satisfactory explanation of the rise of the myth of negotiability, the fact that the myth is false has various implications for modern commercial law and for legal history.

VIII. IMPLICATIONS FOR MODERN COMMERCIAL LAW

The principal effect of the myth of negotiability on modern commercial law is that the concept of negotiability plays a central role in the organization of the statutes, treatises, and course books. Yet, if the concept of negotiability is not a response to a universal mercantile need, but a somewhat peculiar phenomenon of late nineteenth century legal thought, then it is by no means obvious that it should play a dominant role in the organization of commercial law in the late twentieth century.

A lawyer or law student asked to explain to a layman what Article 3 of the Uniform Commercial Code is about would probably say something like, "Well, it's about checks and promissory notes and things like that." Checks and notes are common features of ordinary financial life, so it seems entirely sensible that there should be a body of law designed to specify the rights and duties of users of such instruments, just as in the eighteenth century there was an exogenously defined body of law governing the problems that arose in connection with the use of bills and notes in the pre-modern payment system. Although it might make sense to have a special body of law for notes used as standard form contracts in lending transactions, or checks used as standard form instructions in payment transactions, Article 3 is no such thing. Perhaps the clearest instance of the incongruity between law and practice is the formal definition of "negotiable instrument" that determines whether a given instrument is governed by Article 3. It is standard practice in commercial paper casebooks to begin with a section posing the difficulties of determining whether such things as floating interest rate notes, money orders, travelers checks, credit card slips, credit union drafts, and the like fit within the Article 3 definition of negotiable instrument. One has the suspicion that the reason for raising these problems toward the beginning of the course is to show students that some interesting and important modern issues really lurk in the dry classificatory rules of Part 1 of Article 3. Yet,

isn't the real moral precisely the opposite: if there is something important about Article 3, why do bankers and businessmen seem to have no reluctance about devising and using a myriad of forms of instruments that either are not covered by Article 3, or are questionably covered?

Similarly, the content of Article 3 is determined less by the actual problems that arise in connection with modern uses of notes or checks, than by the needs of a system of rules adapted to a theoretical system in which instruments are circulated from party to party. In modern commercial practice, notes used as simple lending contracts generally remain in the hands of the lender, and checks are not circulated but immediately deposited for collection. The great bulk of Article 3, however, is devoted to rules governing the mechanics of transfer of instruments and specifying the rights of transferees. Arcane points are amply covered, such as whether it is permissible to place indorsements on a separate sheet of paper once the back of the note has been filled up with prior indorsements.¹⁵⁴ On the other hand, we find essentially nothing about recurring real world problems involving the use of promissory notes, such as whether taking a note for a debt amounts to satisfaction of the prior debt;¹⁵⁵ whether giving a note or renewal note for a debt precludes the debtor from raising defenses of which he had knowledge at the time the note was given;¹⁵⁶ whether cancellation of a note by mistake or fraud operates as a discharge of the debt;¹⁵⁷ whether parol evidence is admissible to alter the apparent terms of a note;¹⁵⁸ whether a purported agent has authority to bind his principal to a note,¹⁵⁹ and so on. Indeed, it is entirely possible for

¹⁵⁴ U.C.C. § 3-202(5).

¹⁵⁵ Section 3-802(1) says only that "unless otherwise agreed" taking an instrument for an obligation only suspends the obligation. As the voluminous caselaw indicates, the difficult issue is to specify what circumstances should be construed as amounting to such an agreement. See, e.g., Annotation, *Renewal Note Signed by One Comaker as Discharge of Non-signing Comakers*, 43 A.L.R.3d 246 (1972); Annotation, *Renewal Note as Discharging Original Obligation or Indebtedness*, 52 A.L.R. 1416 (1928).

¹⁵⁶ See, e.g., Annotation, *Account Stated Based Upon Check or Note Tendered in Payment of Debt*, 46 A.L.R.3d 1325 (1972); Annotation, *Trade Acceptance or Unsecured Note or Bill of Debtor as Accord and Satisfaction*, 62 A.L.R. 751 (1929).

¹⁵⁷ See, e.g., Annotation, *Unintentional Cancellation of Negotiable Instrument Under UCC Article 3*, 59 A.L.R. 4th 617 (1988).

¹⁵⁸ See, e.g., Annotation, *Admissibility of Parol Evidence to Show that a Bill or Note was Conditional, or Given for a Special Purpose*, 20 A.L.R. 421 (1922) & supp.; 54 A.L.R. 702 (1928); 105 A.L.R. 1346 (1936); Annotation, *Parol-Evidence Rule: Evidence of Agreements as to Manner or Medium of Payment of Bill or Note, or as to Credit, Set-Off, or Counterclaim with Respect to the Same*, 71 A.L.R. 548 (1931).

¹⁵⁹ Section 3-403 spells out in some detail the rules on whether the agent is personally

a law student to attain a complete mastery of "Article 3," and yet never have gained any useful sense of how to resolve many of the problems that actually arise in connection with the use of notes in the modern world.

In some respects, we are beginning to see the law of commercial paper discarding the concept of negotiability as an organizational principle. Increasingly, the law of the check system is being described not as part of the law of negotiable instruments, but as one aspect of the law of payment systems, along with other funds transfer mechanisms, such as bank credit cards and electronic funds transfers. Fortunately, the agenda for the law of payments systems is not being set by definitional rules about the form of instruments or by abstract concerns about rules of transfer. Rather, an examination of the legal literature of payment systems in the 1970s and 1980s suggests that the legal issues are determined by the practical problems of specifying the rights and duties of providers and users of funds transfer systems: When is payment final? To what extent are providers of funds transfer services liable for consequential damages from failure to complete transfers? When do deposited funds become available for withdrawal? What principles should be used in the allocating of risks of fraudulent transfers? Indeed, within another decade or so, this aspect of commercial law may have recovered fully from the myth of negotiability and become again what the classical law of bills and notes actually was—an exogenously defined law of the payment transactions actually used in commerce.

It is far less clear what will or should happen to the remaining core of negotiable instruments law after the law of the check-based payments system migrates from Article 3 to some form of comprehensive payments system law. Indeed, it is not clear what remains. If Gilmore was right in thinking that consumer lending transactions made negotiability important in the late nineteenth and early twentieth century, then the principal subject matter of the law of negotiable instruments was eliminated by the judicial, legislative, and administrative developments of the 1970s that made the holder in due course rules inapplicable in consumer transactions.¹⁶⁰ More-

liable, but leaves to general agency law the question that is usually of far more concern to someone trying to enforce the debt—whether the principal is bound. By contrast, the treatises of the classical era and nineteenth century contained lengthy chapters dealing with the problems of agency and capacity that arose in connection with instruments purporting to bind principals, corporations, partnerships, and the like.

¹⁶⁰ Similarly, if the rise of the concept of negotiability is to be attributed to developments in the markets for investment securities, then we are left with the peculiar circumstance that

over, once we realize that the history of bills and notes is not nearly as simple as it has usually been portrayed, it is no longer so clear that exclusion of consumer transactions from the scope of the holder in due course doctrine is a sufficient response to the problems of adapting negotiable instruments law to modern practice.

Consider, for example, a business transaction of essentially the same form as the consumer transactions to which the holder in due course rules were applied until the developments of the 1970s. Suppose that a business is sold, the seller takes a note for part of the purchase price, and the seller discounts that note with a bank or other financial entity. If the buyer seeks to withhold payments on the note upon discovery that the representations and warranties in the purchase and sale agreement were false, is it so clear that the bank should be given holder in due course status? If the holder in due course rules developed in response to credit transactions in which borrowers raised money by issuing notes expecting them to be traded in a credit market, in which private notes were frequently traded from party to party, then whether it is appropriate to continue to apply the holder in due course rules in business transactions depends on whether the modern credit system continues to operate in that fashion. If the characteristic discounting transaction in the business setting is simply a transfer of the note from the payee to a financier who retains it to maturity, then one might well contend that the transaction, being structurally identical to the classic consumer finance transaction, should be treated in the same fashion.

I do not, of course, contend that this article has demonstrated that the concept of negotiability plays no useful role in any modern commercial transaction, or that the body of law now found in Article 3 is entirely otiose. On the other hand, if my arguments about the legal history of the law of bills and notes are correct, then at least one major foundation of much argumentation about modern commercial law is severely undercut. In twentieth century negotiable instruments law, one commonly finds arguments of the general form that although various aspects of this body of law seem odd, and particular rules may seem harsh or even unfair, the law of negotiable instruments has stood the test of time and shown itself to promote the general good of commerce. If the traditional account

the instruments that may have given rise to the concept of negotiability are no longer governed by the "law of negotiable instruments." With the enactment of the Uniform Commercial Code, the law of investment securities split off from its ancestry in the law of bills and notes and developed into a separate body of law, now governed by Article 8 of the Code.

of the history of negotiability is a myth, then such appeals to the lessons of history are quite unjustifiable. Rather, the application of negotiability concepts to particular modern transactions must be assessed in light of the particular needs of those transactions.¹⁶¹

IX. IMPLICATIONS FOR LEGAL HISTORY

The assumptions that the concept of negotiability have always been the keystone of the law of bills and notes, and that the law of bills and notes developed in response to a universal mercantile need for debt instruments that could circulate as payment media free from defenses and claims, have had a significant impact on the study of the history of commercial law. Thus, the major implication of the findings presented in this article is that the traditional accounts of commercial legal history need to be re-examined.

At the most general level, the thesis that negotiability was a relatively unimportant aspect of the law of bills and notes in the classical era calls into question one of the foundations of the standard accounts of the incorporation of the law merchant into the common law in the seventeenth and eighteenth centuries. Although the incorporation theory has been widely accepted by twentieth century scholars of commercial law and legal history, it has not gone unchallenged. In an important article published in 1979, the English legal historian John Baker argued that recent research in the early records of the common law courts refutes one of the central tenets of the incorporation theory—that prior to the seventeenth century the common law courts did not handle cases concerning bills.¹⁶² Baker suggests that the seemingly sudden appearance of cases concerning bills in the seventeenth century is not the result of incorporation of an alien body of law, but of developments in pleading rules purely internal to the common law system. Roughly, Baker's thesis is that prior to the development of *assumpsit* as a mechanism for the enforcement of contractual obligations, the pleadings

¹⁶¹ I have elsewhere argued that such an assessment leads to the conclusion that negotiability concepts are at best irrelevant, and often harmful, both in modern payment systems law, see Rogers, *The Irrelevance of Negotiable Instruments Concepts in the Law of the Check-Based Payment System*, 65 TEX. L. REV. 929, 943-45 (1987), and modern law of investment securities, see Rogers, *Negotiability as a System of Title Recognition*, 48 OHIO ST. L.J. 197 (1987). A forthcoming article by Professor Charles Mooney of the University of Pennsylvania Law School sets out a far more comprehensive and sophisticated argument for moving beyond the concept of negotiability in the law of investment securities.

¹⁶² Baker, *The Law Merchant and the Common Law Before 1700*, 38 CAMBRIDGE L.J. 295 (1979).

in an action involving a debt represented by a bill would not have mentioned the bill explicitly, so that the surviving written records generally do not reveal whether suits involved such instruments. Proceeding from an entirely different perspective, my colleague Daniel R. Coquillette has confirmed Baker's suspicions about the incorporation theory. Based on his exhaustive study of the work of the English Civilians, Coquillette has argued that although elaborate discussions of legal issues involving bills of exchange are found in the works of continental and English civilian authors in the sixteenth and seventeenth centuries, virtually no evidence exists that the English common law actually drew on these sources in developing the substantive law of bills in the seventeenth and eighteenth centuries.¹⁶³

The evidence presented in this article about actual commercial practice and law concerning bills and notes in the classical era provides yet another basis for questioning the incorporation theory. The usual accounts of the incorporation of the law merchant into the common law are largely based on the assumption that the struggle for recognition of the law merchant's principle of negotiability was the central theme of the development of the law of bills and notes. If I am right in thinking that this account of negotiability is pure myth, then to the extent that the incorporation theory developed as an explanation of the process by which the common law accommodated the universal mercantile need for negotiability, the theory is an answer to a misleading question.

Turning from general jurisprudential theories about the development of commercial law to the specifics of the history of the law of bills and notes, the evidence presented in this article suggests that much of the traditional account of the history of negotiable instruments law requires re-examination. Although there is an extensive body of work on the history of the law of bills and notes,¹⁶⁴ the starting point of essentially all of the work has been the view of negotiable instruments law that I have argued is a myth. Legal

¹⁶³ Coquillette, *Legal Ideology and Incorporation IV: The Nature of Civilian Influence on Modern Anglo-American Commercial Law*, 67 B.U.L. REV. 877 (1987).

¹⁶⁴ Among the standard works are J.M. HOLDEN, *THE HISTORY OF NEGOTIABLE INSTRUMENTS IN ENGLISH LAW* (1955); 8 W. HOLDSWORTH, *A HISTORY OF ENGLISH LAW* 113-76 (2d ed. 1937); T.E. SCRUTTON, *THE ELEMENTS OF MERCANTILE LAW* 22-40 (1891); T.A. STREET, *THE FOUNDATIONS OF LEGAL LIABILITY* 323-428 (1906); Beutel, *The Development of Negotiable Instruments in Early English Law*, 51 HARV. L. REV. 813 (1938); Fifoot, *The Development of the Law of Negotiable Instruments*, 1938 J. INST. BANKERS 433; Jenks, *The Early History of Negotiable Instruments*, 9 L.Q. REV. 70 (1893).

historians have assumed that the law of bills and notes developed in response to a universal mercantile need for debt instruments that could circulate as payment media free from defenses and claims. Accordingly, the objective of legal historians in this field has been to trace the process by which the principle of negotiability developed in English law. Perhaps nowhere is this focus made more explicit than in the most influential treatment of the history of negotiable instruments law, W.S. Holdsworth's discussion in the eighth volume of his monumental *History of English Law*. Holdsworth begins his discussion of the history of negotiable instruments law with a definition of negotiable instruments as instruments possessing the three legal characteristics of transferability, presumption of consideration, and the special rights given to bona fide purchasers. Holdsworth then sets his task to be as follows: "Thus the questions which I must try to answer are, first, what were the germs from which instruments *having these qualities* were developed; and, secondly, what were the technical processes by which this development took place?"¹⁶⁵ Holdsworth is not proposing to examine the use of instruments such as bills and notes in early commerce, the legal problems presented by such uses, or the legal solutions and techniques applied to such problems. Rather, he makes it quite explicit that his endeavor is to trace the development of instruments having the specific legal characteristics that by his time had come to be regarded as the central aspects of the doctrine of negotiability.

Although Holdsworth is unusually explicit in his statement of the principle by which he defines his subject, the same approach is found in the work of essentially every other legal historian who has written on this topic since the late nineteenth century. A prime example is Thomas Scrutton's influential book on mercantile law and history.¹⁶⁶ Scrutton's chapter on the history of negotiable instruments is devoted exclusively to a discussion of the process by which negotiable instruments law threw off the common law principles that choses in action are not transferrable and that a transferee can get no better title than his transferor. There is little discussion of how merchants actually used the instruments in question, and no mention of any legal issues or problems other than those related to the concept of negotiability in the sense of the special rights given to bona fide purchasers.

¹⁶⁵ 8 W. HOLDSWORTH, *supra* note 164, at 114 (emphasis added).

¹⁶⁶ T.E. SCRUTTON, *supra* note 164.

One striking indication of the way in which the legal history of negotiable instruments law has been influenced by the myth of negotiability is the matter of the data that are thought to be relevant to the story. For example, one of the earliest modern treatments of the legal history of negotiable instruments law is Professor Jenks's 1893 article.¹⁶⁷ Jenks begins by noting the evidence that some form of bills of exchange were in use among Italian merchants from at least the beginning of the fifteenth century. Then, without any discussion of how those instruments might actually have been used, he turns to an explanation of how the legal system adapted itself to those features of negotiable instruments that are, as he puts it, "wholly opposed to the spirit of early law." Having slipped—probably unknowingly—from the question of the history of the negotiable instruments in the sense of actual merchant practices and law, into the history of legal concepts of transfer of rights, any writing that was in any way related to transfer of rights became for Jenks a significant datum in the story, whether or not it had anything to do with the mercantile practices that were the starting point. Accordingly, the remainder of Jenks's article describes the findings of continental legal historians concerning a miscellany of instruments, ranging from a writing "in which a monk makes over to a church (amongst other things) the right to avenge his death if he shall be murdered," to various clauses in wills concerning the designation of guardians and the like, to real estate conveyance instruments, as well as bonds evidencing debts and early bills of exchange. If one started out with an open mind to write a history of mercantile credit and payment instruments, it is hardly likely that the first thing that would come to mind would be instruments whereby monks make over inchoate *wergild* rights.

Unquestionably, the conclusions reached by the legal historians about the history of the law of bills and notes have been profoundly influenced by the single-minded focus on the concept of negotiability. One searches the writings of the legal historians in vain for any serious discussion of what merchants were actually doing with the writings that are taken to be the focus of the inquiry, for any serious examination of whether the transferability of debt instruments was actually a significant matter to the mercantile community, or for any recognition that there may have been changes in commercial practice and needs over the millennia. Rather, one finds an

¹⁶⁷ Jenks, *supra* note 164.

account that an irreverent wag might term the "Holy Grailing" theory of the history of bills and notes: a history dedicated to finding the earliest instance of the use of the "order clause" or the "bearer clause" in an effort to push back further and further toward the discovery of that momentous day when the Principle of Negotiability first dawned on the human consciousness.

Indeed, the ahistorical nature of the standard accounts of the history of the law of bills and notes is perhaps the most surprising thing about them. The basic assumption of legal history in this area has been that mercantile conditions have remained fundamentally unchanged over the centuries. Merchants have always needed debt instruments that were freely transferrable as a means of payment; the only problem has been to persuade the legal system to recognize this universal need and work out the details of a system of rules that accommodates it. Thus, we have an established tradition of commercial legal history that eliminates, at the level of axiom, any need for inquiry into the influence of economic, financial, political, or social forces and conflicts on the development of legal rules and institutions.

The discussion of the actual law of bills and notes in the classical era set out in this article provides some indication of what may be found by re-examining the history of this body of law free from the assumptions of the myth of negotiability. For example, we have seen that many of the specific rules of classical bills and notes law reflected the needs of the commission agent system of distribution. Similarly, we have seen that many of the problems that strike a modern observer as disputes over fine points of a law gone wild with its own technicalities were actually the product of the understandable litigiousness of those caught in the high stakes game of musical chairs that inevitably followed the dishonor of bills. In a sense, these results are not in the least surprising. The law of bills and notes in the classical era was a product of the characteristic economic transactions of the era. Presumably, similar conclusions would emerge from further examination of the history of the law of bills and notes in the classical era and in earlier or later periods. Far from throwing the history of commercial law into turmoil, rejection of the myth of negotiability opens the door to the sort of examination of relationships between law and economic, political, or social forces that is commonplace in every other field of legal history.

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